COUNCL AGENDA: 02/09/16
ITEM: 4.3

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Julia H. Cooper
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: January 28, 2016

Approved D. DSyl Date 1/28/16

COUNCIL DISTRICT: 5

SUBJECT: TEFRA HEARING FOR CALIFORNIA STATEWIDE COMMUNITIES DEVELOPMENT AUTHORITY'S ISSUANCE OF TAX-EXEMPT MULTIFAMILY REVENUE BONDS TO ACQUIRE AND REHABILITATE THE COURTYARD PLAZA APARTMENTS

RECOMMENDATION

1. Allow an exception to the City's Policy for the Issuance of Multifamily Housing Revenue Bonds ("Policy") to permit the California Statewide Communities Development Authority ("CSCDA") to issue private-activity bonds for the acquisition and rehabilitation of the Courtyard Plaza Apartments ("Apartments"), an 81-apartment complex owned by an affiliate of WNC & Associates, located at 2950 Story Road in San José;

2. Hold a Tax Equity and Fiscal Responsibility Act ("TEFRA") Public Hearing for the issuance of up to $18,000,000 in tax-exempt private-activity bonds ("Bonds") by CSCDA for the Apartments; and

3. Adopt a resolution approving the issuance of Tax-Exempt Revenue Bonds by CSCDA in a principal amount of up to $18,000,000 to be used to finance the Apartments and to pay certain expenses incurred in connection with the issuance of the Bonds.

OUTCOME

Approval of the recommended action will authorize CSCDA to issue tax-exempt bonds to permit the acquisition and rehabilitation of the Courtyard Plaza Apartments, an existing affordable apartment property formerly known as Park Sequoia Apartments located at 2950 Story Road. It will also result in lengthened affordability restrictions on 80 apartments, preserving the supply of affordable housing in San José.

BACKGROUND

The California Statewide Communities Development Authority ("CSCDA") has requested that the City of San Jose ("City") consent to its issuance of up to $18,000,000 in tax-exempt bonds ("Bonds") for the Courtyard Plaza Apartments ("Apartments"), located at 2950 Story Road in San José. The bond proceeds and other sources, including low income housing tax credit equity, will finance the acquisition and rehabilitation of the existing restricted affordable Apartments.

CSCDA is a statewide Joint Powers Authority, of which the City is a member. For CSCDA to issue bonds in San José, it must request permission pursuant to its membership agreement. City staff then determines whether the issuance comports with the City's Policy for the Issuance of Multifamily Housing Revenue Bonds ("Policy"). Given that this issuance does not comport with the City's current Policy, as discussed in the Analysis section, CSCDA requests that the City Council make an exception to its Policy to permit CSCDA's bond issuance and to hold a public hearing on the forthcoming issuance.

The Apartments–also known as Park Sequoia Apartments–were built in 1965 and already offer restricted affordable rents. WNC & Associates ("WNC"), the for-profit developer based in Anaheim that specializes in building and investing in affordable tax credit developments, is currently part owner and sponsor of the Apartments. WNC purchased and rehabilitated the property in 2000 and is now seeking funding to recapitalize the Apartments. Recapitalization—involving financial restructuring and improvements being made to a property—is an action on existing low income housing tax credit properties which is typical and is to be expected at certain periods in properties' lifecycles. As the Apartment's tax credit compliance period of 15 years has ended, it is allowable under federal IRS rules for the Apartments to receive a new tax credit allocation to rehabilitate the property. A concurrent change in ownership will also result, as tax credit equity investors are typically 99% owners of tax credit-financed properties.

The current restricted rents are enforced by CSCDA's bond regulatory agreement from 2000, the year in which WNC first purchased and rehabilitated the existing apartments initially. After its financing, the restrictions will continue as they are now—eight of the 81 Apartments will offer restricted rents serving tenants with maximum incomes of 50% of the area median income ("AMI"), 72 apartments will offer restricted rents for tenants at or below 60% AMI, and one apartment for a resident manager will remain unrestricted. The resulting rents initially are expected to range from $1,111 to $1,408 per month for the studios, one-, and two-bedroom apartments—an estimated savings of between $329 and $745 per month over market rents. The residents' maximum household incomes remain in the range of approximately $33,720 to $57,420, depending on apartment size and income restriction.

The Apartments are in a desirable location within in a mixed-use neighborhood in the eastern portion of the City, with major shopping, schools, and recreational amenities located within a short distance. Access to groceries, pharmacy and shopping is convenient and is within reasonable walking distance. Located on a large 3.53-acre lot, the Apartments also offer community space, a grilling area, a playground, a reflection pool, and a swimming pool for residents' use. The current waitlist is over two years long.

For the purposes of this financial recapitalization, WNC requested that CSCDA apply to the California Debt Limit Allocation Committee ("CDLAC") for an allocation of bonding capacity for the Apartments. CDLAC is expected to allocate the requested bond capacity at its March 16 meeting. In addition, WNC also is seeking 4% low income housing tax credits and a potential tax credit equity investor.

A portion of tax-exempt bond proceeds must be spent on physical improvements; therefore, approximately $4,400,000 in property improvements will be made in conjunction with this transaction. The remainder of the Bond proceeds and tax credit equity will be used to finance the arms'-length acquisition of the property by a new legal entity, pay for hard and soft transaction costs, and initially capitalize reserves. The scope of rehabilitation will address health and safety issues, accessibility requirements, deferred maintenance, and energy efficiency enhancements. Currently, the Developer is planning on replacing all countertops and cabinetry in units, replacing the windows, painting the kitchen and baths, adding fencing, addressing parking lot deferred maintenance, and replacing and upgrading building systems as necessary. Work is expected to start in May 2016 and conclude in December 2016. While it is possible that some residents may need to stay briefly in another location so that their apartments can be renovated, most of the rehabilitation is expected to take place with the tenants in place. No permanent displacement of residents is anticipated from the rehabilitation or the financial restructuring.

As a pre-condition for the exclusion from gross income for federal income tax purposes of interest on all qualified private activity bonds, the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") requires, among other things, that the proposed bond issue be approved (a "TEFRA approval") either by an elected official or body of elected officials of the applicable governmental entity after a public hearing (a "TEFRA hearing") following reasonable public notice (a "TEFRA notice"). A qualified private activity bond is a bond issued to fund a project for a private entity, which must meet certain requirements under the Internal Revenue Code (the "Code") in order for the interest received by the bondholder to be excluded from gross income for federal income tax purposes. TEFRA hearings provide interested individuals or parties the opportunity to comment on any matters related to such potential bond issues, including the nature and location of the project.

ANALYSIS

City Council Policy for the Issuance of Multifamily Housing Revenue Bonds

The City Council's Policy for the Issuance of Multifamily Housing Revenue Bonds ("Policy") requires that the City be the issuer of tax-exempt private-activity bonds for housing developments located within the City of San José. When the City is not the issuer, the Policy allows the City to authorize another conduit bond issuer—in this case, CSCDA—to issue bonds if two conditions are met: 1) the City is not making a loan or grant to the project; and 2) the project is one of multiple projects in the same round of CDLAC allocations under a similar financing program so as to result in economies of the costs of issuance. Although it is the City's practice to require that the City be the issuer of bonds for all projects in San José, on rare occasions, the City Council and/or City staff have approved developers' use of an alternate issuer pursuant to the Bonds Policy.

This proposed transaction does not comport to the conditions for approving conduit issuers under the City's Policy. While the first of the Policy's conditions is met—there is no prior, existing, or future City loan or grant on the Apartments—the second part regarding multiple concurrent issuances is not met: WNC only has a single bond issuance anticipated to be approved in the forthcoming CDLAC allocation round.

Regardless, staff agrees that a new CSCDA bond issuance is warranted for the following reason. Pursuant to the existing bond regulatory agreement from CSCDA's 2000 bond issuance, CSCDA must monitor affordability of the Apartments and report to CDLAC for 55 years from the date of issuance—until October 2055—regardless of whether those original bonds remain outstanding. If the City was the issuer of the new Bonds for this project, both the City and CSCDA would monitor the same rent and income levels for the next 40 years. While other details in this new bond issuance may differ slightly from the original, and the annual bond monitoring activities therefore may differ slightly under the current CDLAC rules, the Apartments' rent restrictions will be the same as under the original issuance. As the verification of the rent and income limits is the main, material function of bond monitoring, it would be inefficient to have the City basically duplicate CSCDA's existing bond monitoring work with little value added to the process. Additionally, CSCDA is receiving a monitoring fee during the outstanding life of the bonds that would be duplicated if the City were to issue conduit bonds for this project.

The proposed issuance of bonds will result in a new 55-year bond regulatory agreement that will ensure restricted rents for an additional 16 years over the current bond regulatory agreement. By enabling CSCDA to issue bonds, City staff will spend a minimal amount of work but the community will enjoy the positive benefits of longer affordability. Recapitalizations similar to this transaction promote the City's goals stated in its current Housing Element to extend restrictions for existing affordable properties as a preservation strategy.

Therefore, the Finance and Housing Departments jointly recommend an exception to the Policy to allow for bonds issued by CSCDA for this purpose. Staff is reviewing amendments to the

Policy and expects to return to the City Council with a recommendation to clarify that conduit issuers such as CSCDA be allowed to reissue bonds in situations with similar facts as in this transaction.

TEFRA Hearing

Federal tax law limits the types of projects that may be funded with tax-exempt bond proceeds since the interest earned on such bonds is exempt from federal taxation. Pursuant to the Code, the issuance of the Bonds by CSCDA requires the City's approval because the Project is located within the territorial limits of the City. In order for the interest on the Bonds to be excluded from the gross income of the owner of the Bonds (i.e. tax-exempt), an "applicable elected representative" of the government unit must approve the issuance of the Bonds after the TEFRA hearing. The City Council's approval of CSCDA's issuance of the Bonds and the use of the proceeds serves to meet the applicable Code requirements. The City Council's approval of this action is not approval of the Apartments for any other purpose.

Pursuant to the Policy, in situations in which the City allows an external agency such as CSCDA to issue the bonds, the City Council must hold the TEFRA hearing. The Director of Finance's delegation of authority under Chapter 5.06 of the Municipal Code is limited in allowing staff-level TEFRAs to be held to those cases where the City will be the issuer. Therefore, as part of this action, a specially-noticed public hearing will be held to satisfy the TEFRA requirements.

EVALUATION AND FOLLOW-UP

There is no planned City Council follow-up anticipated as part of this action; however, staff will seek confirmation of the bond issuance and obtain the new CSCDA bond regulatory agreement in its work to track all restricted affordable housing in San José.

POLICY ALTERNATIVES

To arrive at this proposal, staff considered the following options:

Alternative #1:	***Deny CSCDA's bond issuance request.***
Pros:	The City would receive upfront and annual issuer fees that would add to the City's resources.
Cons:	It would be inefficient to basically duplicate CSCDA's bond monitoring activities for the next 40 years, for which the property would be double-charged. With little staff work, the CSCDA issuance will result in an additional 15 years of affordability.
Reason for not recommending:	To promote efficient use of scarce City staff resources and fairness to the property owner, staff does not support this alternative and instead recommends approval of CSCDA's bond issuance.

PUBLIC OUTREACH

A public hearing notice regarding the TEFRA hearing to be held as part of the actions recommended in this report is scheduled to be published in the Post-Record on or about January 26, 2016. This report will be posted to the agenda website for the City Council's February 9, 2016 meeting. CDLAC's scheduled committee meeting to approve the bond allocation is open to the public and will be held in Sacramento at the Jesse Unruh Building, 915 Capitol Mall, in Room 587 on March 16, 2016.

COORDINATION

This memorandum has been prepared in coordination with the City Attorney's Office.

COST IMPLICATIONS

By not exercising its option to be the bond issuer, the City will forego the issuance fees and the annual fees associated with the bond monitoring obligation; however, the City will receive its $5,000 TEFRA hearing fee for non-City bond issuances in conjunction with this action. There are no other fiscal impacts to the City as there are no City funds in these Apartments. Repayment of the tax-exempt bonds issued by CSCDA will be secured solely by the Apartments' revenues.

FISCAL/POLICY ALIGNMENT

This action is consistent with the City's Consolidated Plan 2015-2020, adopted by the City Council on May 5, 2015, and with the City's Adopted Housing Element 2014-2023 in that the action preserves existing homes for very low-income households.

CEQA

Not a Project, File No. PP10-069, City Organizational and Administrative Activities.

/s/	/s/
JULIA H. COOPER	JACKY MORALES-FERRAND
Director, Finance Department	Director, Housing Department

For questions please contact Kristen Clements, Division Manager, at 408-535-8236.

Attachment

EXHIBIT A
SITE MAP