



REPORT

DATE ISSUED: November 7, 2003

ITEM 101

REPORT NO: HCR03-100
For the Agenda of November 14, 2003

SUBJECT: Multifamily Housing Revenue Bonds for the Hillside Garden Apartments
(Council District 7)

SUMMARY

Issue No. 1: Should the Housing Commission recommend that the Housing Authority and City Council take the initial steps to issue tax-exempt multifamily housing revenue bonds to finance the acquisition and rehabilitation, and to preserve the housing affordability of a 380-unit multifamily development by KOR Realty Group, LLC?

Recommendation: No. 1: That the:

- A. Housing Authority approve an Official Intent Resolution to issue up to \$27 million in multifamily housing revenue bonds to finance the acquisition and rehabilitation of a 380-unit multifamily development located at 5802 University Avenue (Council District 7);
- B. Housing Authority approve applications to Round I and, if necessary, subsequent rounds of the State's 2004 allocation rounds for bond issuing authority; and,
- C. City Council hold a public hearing (*known as a TEFRA hearing - Tax Equity and Fiscal Responsibility Act*) and adopt a resolution approving the issuance of bonds by the Housing Authority.

Issue No. 2: Should the Housing Commission approve a financing team from the previously approved list of Financial Advisors and Bond Counsels to work on preparing the proposed bond issuance?

Recommendation No. 2: That the Housing Commission approve Mr. Joe Litten of Public Financial Management as financial advisor and Quint & Thimmig as bond counsel to begin work on the project.

Housing Affordability Impact: The current affordability restrictions on the project, set to expire in 2005, require 25 percent (95) of the apartments at 65 percent AMI (\$41,450 for a family of four) with the remaining units rented at fair market value. At a minimum, after rehabilitation, the developer will



restrict 10 percent of the apartments at 50 percent AMI (\$31,900 for a family of four), and 30 percent of the apartments at 60 percent AMI (\$38,280 for a family of four). The affordability restrictions will remain in place for 55 years.

Future Related Action(s): Specific authorization to issue bonds for the project will be sought from the Housing Commission and Housing Authority at a future date (Refer to Attachment 1, Section 4 “Final Bond Approval”).

BACKGROUND

There are two primary ways the Housing Commission provides financial assistance for development of affordable housing: 1) direct lending of Housing Commission HOME and Housing Trust Fund monies; and 2) issuance of tax-exempt multifamily housing revenue bonds through the Housing Commission’s multifamily bond program. The Housing Commission utilizes the Housing Authority’s tax-exempt borrowing status to pass on lower interest rate financing to developers of affordable housing. Presently, the Housing Commission administers \$515,239,440 in multifamily tax-exempt financing for 35 projects with 8,913 units. Of that total, 4,081 units are restricted at various levels of affordability.

Some projects require both bond financing and direct lending from the Housing Commission. This report pertains specifically to the issuance of tax-exempt multifamily housing revenue bonds, as the project will not require other financing assistance from the Housing Commission.

The Housing Authority’s ability to issue bonds is limited under the U.S. Internal Revenue Code. The California Debt Limit Allocation Committee (“CDLAC”) accepts applications generally two to three times during the year (funding “rounds”), and typically receives more applications for bonding authority than it has available.

Prior to the CDLAC funding rounds, projects are brought to the Housing Commission, Housing Authority and City Council. Official Intent Resolutions must be obtained prior to application submittal and TEFRA resolutions must be secured no later than 30 days after application submittal.

A general description of the Multifamily Bond Program and actions that must be taken by the Housing Authority and the City Council to initiate and finalize the proposed financings are described in Attachment 1.

PROJECT NARRATIVE

On November 15, 1985, the Housing Authority originally issued bonds for the Hillside Gardens Apartments. Under the 1985 regulatory agreement 20 percent of the units were restricted at 80 percent AMI. On April 12, 1995, the Housing Authority refunded the original bonds with the issuance of

\$13,670,000 in multifamily housing revenue bonds. The regulatory agreement associated with the 1995 bonds, which expires in August of 2005, restricted 25 percent of the units at 65 percent AMI.

KOR Realty Group, LLC (the “Developer”) acquired the Hillside Gardens Apartments (the “Project”) from a pair of California limited partnerships managed by American Assets, Inc. on September 23, 2003, using private sources of capital. However, the developer would like to use tax-exempt bonds as a permanent source of financing. In order for the acquisition costs to be an eligible use of tax-exempt bond proceeds the Housing Authority must approve an Official Resolution of Intent to issue bonds for the Project by November 22, 2003.

Kor Realty Group, LLC has owned and operated apartment properties for over 13 years with a portfolio totaling more than 14,000 units. Kor Realty Group owns and/or controls over 3,700 units in California, including the 104-unit Parkridge Apartments in San Diego. The Developer has completed several major rehabilitation projects and is currently developing two new construction apartment projects. The principles of Kor Realty Group include Bradford Korzen, Jeffrey Smith, and Gregory F. Schem. The developer’s Statement for Public Disclosure is included as Attachment 2.

The Project is located on University Avenue between 54th Street and College Avenue. The surrounding area is characterized by commercial uses along University Avenue with a combination of single family and multifamily residences. Directly across University Avenue from Hillside Gardens is the University Square retail development, which includes Food 4 Less, Hometown Buffet, and a movie theater among its many tenants. The location map is included as Attachment 3.

The Project currently consists of 380 total units with 48 one-bedroom units, 302 two-bedroom units, and 20 two-bedroom duplexes. Current amenities include two swimming pools, a clubhouse, garages, and laundry rooms. The rehabilitation will update the units, improve the clubhouse, and extend the useful life of the development. The current rehabilitation budget is approximately \$3.6 million.

The acquisition and rehabilitation of the Project will increase the number of affordable units, deepen the level of affordability, and extend the term of the restrictions for 55 years. The Developer is currently investigating the legal and financial implications of different project scenarios, including turning the 20 duplexes into a separate for-sale or rental project. If the duplexes were turned into a separate project, the part of the Project subject to the affordable restrictions would be reduced from 380 to 360 units.

At a minimum, 144 units will be restricted at 50% (\$31,900 for a family of four) and 60% AMI (\$38,280 for a family of four) for 55 years. The remaining 216 units will be rented at fair market value. Staff will present the definitive project proposal when the final authorization to issue bonds is sought.

Rent and Income restrictions for the project are outlined in the chart below:

				Average	Restricted		
--	--	--	--	----------------	-------------------	--	--

Type	Square Footage	AMI	Number of Units	Current Rents	Rent (including Utility Allow)	Market Rate	Savings per unit
1 Bed, 1 Bath	650	50%	5	N/A	\$598	\$900	\$302
1 Bed, 1 Bath	650	60%	14	N/A	\$717	\$900	\$183
1 Bed, 1 Bath	650	Market	29	\$894	\$900	\$900	N/A
2 Bed, 1 Bath	738	50%	28	N/A	\$717	\$960	\$243
2 Bed, 1 Bath	738	60%	84	N/A	\$861	\$960	\$99
2 Bed, 1 Bath	738	Market	168	\$940	\$960	\$960	N/A
2 Bed, 2 Bath	950	50%	3	N/A	\$717	\$1,100	\$383
2 Bed, 2 Bath	950	60%	10	N/A	\$861	\$1,100	\$239
2 Bed, 2 Bath	950	Market	19	\$1,089	\$1,100	\$1,100	N/A
Total:			360				

If the 20 duplexes remain a part of the larger project, 10% of the 380 total units will be affordable at 50% AMI (\$31,900 for a family of four), 30% will be affordable at 60% AMI (\$38,280 for a family of four), and the remaining units will be rented at market rates.

SELECTION OF THE FINANCING TEAM MEMBERS

Staff recommends assigning Mr. Joe Litten of Public Financial Management as financial advisor and Quint & Thimmig as bond counsel to work on the project. The proposed financing team members have been selected in accordance with the existing policy for the issuance of bonds. Financial advisors and bond counsels are designated on a rotating basis from the firms selected through a competitive RFP process.

FINANCING STRUCTURE

The total cost for acquisition and rehabilitation of the project is estimated to be \$36.4 million. It is anticipated that the bond-financed loan of approximately \$24.0 will be underwritten utilizing Federal National Mortgage Association (“Fannie Mae”) credit enhancement resulting in a “AAA” rating of the bonds. ARCS Mortgage, Inc. will serve as the project’s underwriter to market and sell the bonds. The developer’s minimum equity contribution is approximately \$8.9 million. A Preliminary Sources and Uses budget is included as Attachment 4.

Pursuant to Housing Authority approval, staff will submit, on behalf of the developer, an application for private activity bond allocation to CDLAC. If successful, the bond financing may qualify the project for an allocation of 4 percent low-income housing tax credits (estimated at \$3.5 million). These proceeds may serve as a contribution of project equity. If the CDLAC application is unsuccessful, at the request of the developer, staff will resubmit the application for subsequent rounds.

In the future, should the Housing Authority, under a separate action, authorize the issuance of bonds for the project, the bonds would not constitute a debt or liability of the Housing Authority or the City of San Diego. Neither the faith and credit nor the taxing power of the City or the Housing Authority would be pledged to the payment of the bonds because the security for the bond repayments is limited to the value of the subject property and its revenue sources. The developer is responsible for the payment of all costs under the financing, including the Housing Commission's annual administrative fee.

RISKS AND MITIGATIONS

Approval of the Official Intent and TEFRA resolutions do not commit the Housing Authority to issue bonds. The recommended actions do not represent any commitment by the Housing Authority or the applicant to proceed with the tax-exempt or taxable financing of the project. When eventually issued, the financing risks associated with the Project will be minimal since repayment of the bonds will be guaranteed by a third party.

ALTERNATIVE

Do not recommend approval of the Official Intent and TEFRA resolutions. If the recommended actions are not taken, the project will not be able to benefit from tax-exempt below-market financing, and the current restricted units could be converted to market in 2005.

Respectfully submitted,

Approved by,
**Signature on File
With Original Document**

Jack D. Farris
Manager, Housing Finance &
Development

Elizabeth C. Morris
Chief Executive Officer

ATTACHMENTS:

1. Description of Bond Program and Actions to be Taken
2. Developer Disclosure Statement and Financial Statements*
3. Project Location Map
4. Preliminary Sources and Uses

*Distribution of this attachment is limited. A copy is available for review at the Housing Commission's 1625 Newton Avenue office and the office of the City Clerk, 2nd floor, 202 "C" Street.

Information: P. ARMSTRONG 578-7556

For the Agenda of November 14, 2003

Issuance of Multifamily Housing Revenue Bonds for Hillside Gardens Apartments

Page 6

ATTACHMENT 1

SAN DIEGO HOUSING COMMISSION MULTIFAMILY BOND PROGRAM

General Description

The Multifamily Bond Program provides below market financing (based on tax exemption of bond interest) for developers willing to set aside a portion of the units in their projects as affordable housing. The issuer of these bonds is the Housing Authority. At the present time, \$515 million in outstanding bonds provides permanent financing for more than 8,900 multifamily rental units in the City, of which 4,081 units are restricted at various levels of affordability.

Bonds issued by the Housing Authority require a minimum "A" rating, which is typically achieved through the provision of an outside credit enhancement by participating financial institutions that underwrite the project loans and guarantee the repayment of bonds.

The authority to issue bonds is limited under the US Internal Revenue Code. The California Debt Limit Allocation Committee (CDLAC) accepts applications generally two to three times a year (funding "rounds"), and typically receives more applications than is available under its financing authority. The state has a \$75 per capita bonding capacity.

The following actions must be taken by the Housing Authority and by the City Council to initiate a bond financing:

1. Official Intent (Bond Inducement)

The adoption of an Official Intent (inducement) resolution is an initial step required by the Internal Revenue Service to initiate a possible new-money bond issuance. It does not represent any commitment by the Housing Authority or the applicant to proceed with the financing. Rather, it establishes, through public record, the date from which project costs incurred may be determined to be reimbursable from bond proceeds. Generally, the Official Intent amount is higher than the estimated bond amount to reflect a 10-15 percent contingency. The adoption also authorizes staff to work with the selected financing team to perform a due diligence process to determine the feasibility of the financing, the level of affordability of the set-aside units and structure a resulting proposal for the issuance of bonds.

2. TEFRA Hearing and Approval

In order for interest on the bonds to be tax-exempt and in accordance with the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, Section 147(f) of the Internal Revenue Code of 1986, the issuance of bonds must be approved by representatives of the governmental unit with jurisdiction over the area in which the project is located after a public hearing for which a reasonable public notice was given. Therefore, federal regulations require that the issuance of bonds by the Housing Authority be

approved by the City Council, as the elected legislative body of the City. A notice of public hearing to be held by the City Council with respect to the proposed issuance of bonds will be published in the San Diego Daily Transcript at least fourteen days prior to the scheduled meeting. The purpose of such public hearing is to provide an opportunity for interested persons to provide their views on the proposed bond issuance and on the nature and location of the project.

3. Bond Allocation

The issuance of bonds for projects owned by private developers (i.e., projects owned by private developers or by nonprofit sponsors with for profit investor participation - "private activity bonds") requires an allocation of a bond issuing authority from the State of California. In order to apply for the bond allocation, an application approved by the Housing Authority and supported by an adopted Official Intent resolution and by proof of credit enhancement (or bond rating) must be filed with the California Debt Limit Allocation Committee (CDLAC). In addition, evidence of a TEFRA hearing and approval must be submitted prior to the CDLAC meeting.

4. Final Bond Approval

The Housing Authority retains absolute discretion over the issuance of bonds through adoption of a final resolution authorizing the issuance. Initially, the information about the proposed tax-exempt financing of the project is preliminary. If the Official Intent and TEFRA resolutions are approved, a due diligence process conducted by staff and financing team members will generate additional information and analysis. Prior to final consideration of the proposed bond issuance by the Housing Authority, the project will have to comply with all the program's financing and affordability requirements, and undergo all required planning procedures/reviews by local planning groups, etc.

ATTACHMENT 4

PRELIMINARY SOURCES & USES BUDGET Hillside Gardens

Sources

Tax Exempt Bond Loan	\$ 24,000,000
Tax Credit Equity	\$3,500,000
Developer Equity	<u>\$ 5,288,122</u>
	\$ 36,400,000

Uses

Land Costs	\$ 31,700,000
Rehabilitation	\$ 3,600,000
Development Costs – Financing	<u>\$ 1,100,000</u>
	\$ 36,400,000