Good Neighbors
San Diego
Housing Commission

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REPORT

DATE: For the Agenda of June 7, 2002 **ITEM 108**

REPORT NO: HCR02-057

SUBJECT: Final Authorization to Issue Multifamily Housing Revenue Bonds for Logan Square Apartments (Council District 4)

SUMMARY

Issue: Should the Housing Commission recommend that the Housing Authority take the final steps to issue tax-exempt multifamily housing revenue Bonds to Logan Square Housing Partners, L.P. for the acquisition and rehabilitation of Logan Square Apartments, a 170-unit property located at 4742 Solola Avenue in Council District 4?

Recommendation: That the Housing Commission recommend that the:

1. Housing Authority authorize the issuance of tax-exempt multifamily housing revenue bonds in an amount not to exceed $10,500,000.

2. 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.

Fiscal Impact: The issuance and sale of the bonds will not financially obligate the City, the Housing Authority or the Housing Commission because security for the repayment of the bonds will be limited to specific private revenue sources. All costs of the financing, including compensation for staff efforts in preparing the bonds, will be borne by the developer. The Housing Commission's origination fee as well as the annual administrative fee under the financing will be up to $24,150 (0.23 percent of the bond amounts).

Housing Affordability Impact: Approval of the recommendation will provide 170 units affordable to families earning no more than 60 per cent of the area median income. Seventeen (10%) of the apartments will be restricted for occupancy by families earning no greater than 50% MAI.

Traffic Impact: No adverse impact as this is an inhabited existing structure that will undergo rehabilitation.

Environmental Review: The proposed project has been determined to be exempt from environmental review under the California Environmental Quality Act (CEQA), pursuant to Section 15061(b)(3) of the CEQA Guidelines, and under the National Environmental Policy Act (NEPA) pursuant to 24CFR58, Section 58.34(a) (12).

Community Planning Group Review: The project was presented to the Encanto Neighborhoods Community Planning Group on May 21, 2001, and at their Special Meeting of June 18, 2001 where it was approved.

Previous Related Actions: On May 11, 2001, the Housing Commission recommended Housing Authority approval of the Bond inducement Resolution and the City Council's approval of the tax-exempt financing through a public hearing (Report No. HCR99-061). The Housing Authority and City Council convened on May 29, 2001, and approved the Housing Commission's recommendations (Housing Authority Resolution Number R-1098 and City Council Resolution Number R-294945).

On October 12, 2001, the Housing Commission recommended Housing Authority approval of: a 3% residual receipts Housing Commission loan of $1,000,000; and, issuance of up to $10,500,000 in tax exempt housing revenue bonds (Report No. HCR01-110). The Housing Authority convened on October 30, 2001, and approved the Housing Commission's recommendations (Housing Authority Resolution Number R-1132 (loan) and Housing Authority Resolution Number R-1133 (bond financing)).

On November 27, 2001, the Housing Authority convened again to approve a resolution (Housing Authority Resolution Number R-1134) to revise the multifamily revenue bond documents to permit the issuance of interim tax-exempt (Bond Anticipation) notes (Report No. HCRO1-110 – Supplemental).

Future Related Action(s): Final approval to issue multifamily revenue bonds will be sought at the Housing Authority meeting of June 25, 2002.

BACKGROUND

The Housing Commission has twice recommended Housing Authority approval of actions to enable the issuance of bond financing for Logan Square Apartments. On both occasions, the Housing Authority approved the Housing Commission's recommendations by authorizing: a bond inducement resolution; a $1 million Housing Commission 3% residual receipts loan; and, the issuance of up to $10.5 million dollars in tax-exempt revenue bonds. A general description of the Housing Commission's Multifamily Bond Program and actions that must be taken by the Housing Authority and by the City Council to initiate and finalize the proposed financing are provided in Attachment 1.

Subsequent to the above-mentioned approvals, due to the Developer's inability to satisfy the primary lender's underwriting conditions within an allotted time, the project was unable to secure the financing approvals needed to close by the CDLAC imposed deadline (November 28, 2001). To salvage the bond allocation, and provide the Developer with sufficient time to secure the requisite financing approvals, the Housing Authority convened on a third occasion (November 27, 2001) to reaffirm its commitment to the project by approving a resolution that revised the previously approved bond documents to enable the issuance of (short term) Bond Anticipation Notes that would be retired by the current proposed bond issuance.

All proceeds from the sale of the Bond Anticipation Notes were deposited with the trustee at the closing and secured by a Guaranteed Investment Contract (GIC). The Notes mature on July 15, 2002, and must be refinanced with bonds to allow for the acquisition and rehabilitation of Logan Square Apartments.

PROJECT NARRATIVE

The Borrower

Avalon Communities, LLC (Avalon) is a development company that seeks to provide affordable housing throughout the western United States. Leo Puig, a co-founder of the firm, heads Avalon. Since its inception in 1997, Avalon has developed six properties totaling 511 units. This includes two properties in San Diego County – 122 units in San Diego (Island Gardens Apartments, acquired in September 2000) and 120 units in El Cajon. All of Avalon's properties have been acquired and rehabilitated with public agency low-interest loans and grants, private institution loans, tax credits and bonds. The Developer's Statement for Public Disclosure is included as Attachment 2. The developer, Avalon, and its nonprofit partner, Casa Familiar, will act as co-managing general partners of Logan Square Housing Partners, L.P. Paramount Financial Group is the proposed tax credit investor that will comprise the limited partner.

It is the developer's intention to hire a still-to-be identified general contractor for the performance of the rehabilitation work. A private management company will perform property management with oversight provided by the local non-profit partner. These entities would be subject to Housing Commission approval.

Preservation of an At-Risk Assisted Housing Project

The current property owner had entered into a Section 236 Program Contract with HUD. Under the terms of the original contract, the owner agreed to complete the original construction of the property in accordance HUD standards. Additionally, the owner agreed to rent 144 units to eligible lower income families whose rent payments would be subsidized by the Section 8 program. The project is now at the point where the owner has the option of terminating its participation in this rental assistance contract. If the owner elects to exercise this option, the subsidy to the project and accompanying use restrictions will be terminated. Units may be converted to market-rate units; this would reduce the local affordable housing inventory. For this reason, this project is listed in Group 1 of the City of San Diego Housing Element's List of At-Risk Assisted Housing Projects.

The Section 236 Program provided private developers with loans that were subsidized by interest reduction payments (IRPs). While the nominal interest rate on these loans would reflect the market rate (e.g., 7%), the sponsors of projects financed by these loans paid a reduced rate of interest (e.g., 1%). HUD subsidized the interest through the IRPs.

Although the proposed financing would pay off the Section 236 debt, the developer expects to maintain the IRPs through its expiration date (January, 2013) in exchange for adhering to the existing Section 8 Housing Assistance Payment (HAP) contract by continuing to allow for 144 of the current families, earning less than 50% MAI, to pay not more than 30% of their income for rent with HUD subsidizing the difference in rental payments to the owner.

The Property

The 170-unit Logan Square Apartment complex was built in 1971. In recent years, the property has been marred by criminal activity, deferred maintenance, and a strong need for rehabilitation and updating. This property is located in the Lincoln Park area of San Diego. It is situated within a residential area with close proximity to I-805 to the west. The area is best described as "in transition" as much effort has taken place to improve the area. The rehabilitation of this project will play a pivotal role in the improvement of the neighborhood. A project location map is included as Attachment 3.

The property offers plenty of open space, recreation facilities, laundry facilities, and ample parking. Working closely with its co-managing general partner, Avalon would provide after-school programs, computer labs, and job placement assistance for the tenants. The nonprofit partner would also work closely with tenants to further ensure that their needs are being met.

Rent and Income Restrictions

The composition of the 170 units is: 52 one bedroom/one bathroom units; 94 two bedroom/two bathroom units; and 24 three bedroom/two bathroom units. Affordability will range from 50% ($30,050 for a family of four) to 60% ($36,060 for a family of four) of area median income per the distribution in the chart below. The affordability restrictions will remain in place for 55 years.

Type	Sq. Ft.	Number of Units	Restricted Rent (net of utility allowance)	Market Rate	Savings
1br@50%	600	5	$601	$625	$24
1br@60%	600	47	$625*	$625	-
2br@50%	795	10	$676	$765	$89
2br@60%	795	84	$765*	$765	-
3br@50%	990	5	$751	$910	$159
3br@60%	990	9	$902	$910	$8
3br@60%	1,000	10	$902	$910	$8
Total Units		170			

***** In the event that the 50% or 60% restricted rents (for any unit type) exceed the market rate, the developer will be required to charge an amount equal to or lower than the market rate.

Currently, there is a HAP contract between HUD and the owner; the contract will be transferred to Logan Square Housing Partners, L.P. Under the contract, HUD may allow the developer to collect HAP contract rents (combination of HUD subsidies and tenant-paid rents) that exceed the lowest rents permitted by other participating programs (Housing Commission, Home, and Tax Credits). The developer would be required to use this additional source of project income to provide enhanced social services to the project. However, under no circumstances will tenants in restricted units be required to pay more than 30% of their income for rent.

Rehabilitation Needs

The complex has three laundry and four water heater room locations and two separate playgrounds. Some areas of the site are exhibiting slope erosion and drainage problems that will be corrected.

In addition to all needed health and safety rehabilitation requirements, the proposed improvements will include added security features as recommended by the San Diego

Police Department's Neighborhood Policing program, new flooring, appliances, window coverings, new paint, updated electrical system componentry and submetering, plumbing, heating system repairs and cabinetry as needed, termite treatment, and a modernized community recreation room/learning center. Most of the buildings share hot water that is provided by eight 100-gallon water heaters situated at four separate locations. It is also proposed to retrofit each building lacking a water heater with independent water heaters, enclosures, and circulating pumps.

The cost to rehabilitate this complex has been budgeted by the developer to be $2,677,500, or $15,750 per unit. This estimate is appropriate based on review by staff. The amount budgeted includes a contingency line per the requirements of the funding sources and lending agencies.

The operating budget includes funds to pay for repairs and replacements anticipated to be needed within the next five, ten, and fifteen years.

FINANCING STRUCTURE

The developer is pursuing a private offering structure under which the Bonds will be purchased by an institutional investor, Newman Financial Services (NFS). In accordance with the Housing Commission's Bond policy, NFS will sign an Investor Letter certifying its understanding of the risks associated with the purchase of the debt instrument. Under this structure, the Commission's minimum rating requirement of "A," or its equivalent, by a recognized rating agency will be waived.

While the note for the Bonds remains unrated, its transferability will be restricted to an institutional investor who signs the Investor Letter. The holder of the tax-exempt note would agree that, should a mortgage default occur, there would not be a bond default. A default under the mortgage loan (including default due to non-payment) would not result in a bond default. In case of default under the mortgage loan, the bondholder would have the ability to accelerate and redeem the Bonds in exchange for the ownership of the project.

The project's sources of financing include: $9.5 million in tax-exempt Bonds; a Housing Commission loan of $1 million, which received final approval on October 30, 2001 and will close simultaneously with the sale of the Bonds; $3.8 million from the tax credit equity investor, which is anticipated to be Paramount Financial Group, $1.2 million in deferred developer's fee, and $715,000 in IRPs from HUD.

RISKS AND MITIGATIONS

Staff has been working with CSG Advisors, Inc., the Housing Commission's financial advisor for this project, to perform due diligence under the proposed financing and in formulating the resulting recommendation for the Housing Authority. After evaluating the project's financial circumstances, the terms of the proposed financing and public benefits to be achieved, it is the financial advisor's recommendation that the bond issuance be authorized. The Financial Advisor's analysis and recommendation to proceed is included as Attachment 4.

Issuances of bonds for the projects do 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 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 properties and their revenue sources. The developer is responsible for the payment of all costs under the financing, including the Housing Commission's annual administrative fees.

If the bond issuance is authorized, the following primary documents will be executed on behalf of the Housing Authority: Indenture of Trust, Loan Agreement, Regulatory Agreement and Bond Placement Agreement. These documents, in a substantially final form, will be on file in the Housing Commission and City Clerk offices at the time of docketing for consideration by the Housing Authority.

At the time of writing this staff report, neither the proposed tax credit equity investor nor the bond purchaser had issued their final commitments for the project. The bonds will not be issued without these funding commitments.

ALTERNATIVE

The Housing Commission could decline to recommend this permanent Bond financing. Without the benefit of the tax-exempt bonds, the developer would not have the requisite financing to acquire and preserve 170 affordable units for low-income renters. If the project is not funded, the owner may sell the property to another private party who most likely would eliminate the HAP contract rent requirements in order to charge the market rate on the units. The City of San Diego would lose an opportunity to accomplish a portion of its objective to preserve "At-Risk" units converting to market rate rents.

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. Housing Commission's Multifamily Bond Program
2. Developer's Disclosure Statement*
3. Project Location Map
4. Financial Advisor's Letter

*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.

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ATTACHMENT 1

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, nearly $500 million in outstanding bonds provides permanent financing for more than 8,590 multifamily rental units in the City, of which 3,778 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. Recent congressional action increased the state's bonding capacity from $50 to $62.50 per capita in 2001 and $75 in 2002.

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

1. Bond Inducement

The adoption of an "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 Commission, 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 bond inducement 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 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 will be 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 a public hearing to be held by the City Council with respect to the proposed issuance of bonds is 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 bonding 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 inducement 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 inducement 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.