



Good Neighbors

San Diego
Housing Commission

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REPORT

DATE: For the Agenda of October 12, 2001

ITEM 105

REPORT NO: HCR01-110

SUBJECT: Loan and 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 approve a loan and take the final steps to issue tax-exempt housing revenue Bonds to Logan Square Housing Partners, LP for the acquisition and rehabilitation of a 170-unit property located at 4742 Solola Avenue in Council District 4?

Recommendation: That the Housing Commission recommend that the Housing Authority:

- approve a Housing Commission 31-year, 3% residual receipts loan of up to \$1,000,000 amortized over 55 years and secured by a second trust deed, subject to the Housing Commission's Chief Executive Officer's approval; and,
- authorize the issuance of up to \$10,500,000 in tax-exempt housing revenue Bonds; and,
- enter into an "Interest Reduction Payments" contract with the project owner, the Department of Housing and Urban Development, and the first position lender to secure additional project income by serving as the "Public Agency" and undertaking administrative duties required by that contract with respect to this project, subject to the Executive Director's approval; and,
- authorize the Executive Director of the Housing Authority or the Chief of Staff of the Housing Commission, or their designee, to execute all documents necessary to facilitate the project's financing, subject to the approvals of General Council for the Housing Authority and Housing Commission.



Fiscal Impact: Approval of the loan would result in the expenditure of up to \$1,000,000 in HOME Program and Housing Trust Funds. Issuance and sale of the Bonds would not financially obligate the City, the Housing Authority or the Housing Commission because security for the repayment of the Bonds would be limited to specific private revenue sources. All costs of the financing, including compensation for staff efforts in preparing the Bonds would be borne by the developer. The Housing Commission's origination fee as well as the annual administrative fee under the financing would be up to \$24,150 (0.23 percent of the total bond amount).

Logan Square Housing Partners, LP will be required to cover the Authority's costs for administering the IRP contract. Additionally, the IRP will enhance the project's cash flow, which, in turn, will accelerate the borrower's repayment of the Commission's loan.

Home Program Compliance: An acquisition and rehabilitation loan is an eligible activity under HOME rules. Of the 170 units, 11 would be HOME funded and subject to HOME rent restrictions. The designated HOME units would consist of (6) two-bedroom units and (5) three-bedroom units. The lower of the HOME "Low Income" or the Housing Commission's "Very Low Income" rents would apply to these units. Housing Commission rent restrictions would apply to the remaining units.

Affordable Housing 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.

Environmental Review: An Environmental Review Request has been submitted to the City's Environmental Analysis Section. It is typically determined that such a proposed project is exempt from review pursuant to Section 15061(b)(3) of the California Environmental Quality Act (CEQA) Guidelines, and under the National Environmental Policy Act (NEPA) pursuant to 24CFR58, Section 58.34(a).

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 -- known as a TEFRA hearing -Tax Equity and Fiscal Responsibility Act -- (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).

Future Related Action(s): Final approval to issue the Bonds and provide the loan will be sought at the Housing Authority meeting of October 30, 2001.

BACKGROUND

On May 11, 2001, the Housing Commission recommended that the Housing Authority take the initial steps to issue Bonds for Logan Square Apartments. At the Housing Authority's meeting on May 29, 2001, the Housing Commission's recommendation was approved.

On May 31, 2001, the Housing Authority, on behalf of the developer, submitted an application to the California Debt Limit Allocation Committee (CDLAC) for a Bond allocation in the amount of \$10,500,000. On August 22, 2001, CDLAC awarded the requested allocation to the project. The project's Bond allocation will automatically revert to CDLAC unless the Bonds are issued by November 20, 2001.

Logan Square Housing Partners, LP subsequently submitted an application for a \$1,000,000 loan under the Housing Commission's Notice of Funding Availability For The Construction, Acquisition And Operation of Affordable Rental Housing. On October 2, 2001, The San Diego Housing Commission Loan Committee recommended that the Housing Commission recommend approval of this loan.

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 financings are described in Attachment 1.

DISCUSSION

The Borrower

Avalon Communities, LLC 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 – that received similar financing as proposed for the subject development. 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, Historic San Diego Community Development Corporation, will act as co-managing general partners of Logan Square Housing Partners, LP. (A profile of the non-profit managing general partner is included at Attachment 3). Alliant Capital, the tax credit investor 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 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 may be able 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 project is being underwritten without consideration of the IRP income, which, if acquired, would be retained as cashflow to the project.

The developer has requested that the Housing Authority participate in the IRP contract with the project owner, the Department of Housing and Urban Development, and the first position lender, and serve as the "Public Agency" to administer the contract. The administrative services entail supervision of the performance of the parties to the IRP contract and notification to HUD of any violations to the contract. The Authority would require the developer to cover its costs for providing these services.

Maintaining the IRP may allow the project to accelerate the payoff of the Commission's loan. Prior to release of the Commission's loan, Commission staff will conduct an analysis to determine whether a reduction in the Commission's loan is warranted due to this additional source of project income. At a minimum, 50% of the enhanced cashflow

will be used to accelerate repayment of the Commission's loan. The Chief Executive Officer of the Housing Commission will approve the Commission's final loan amount prior to the release of those funds.

Also, if, and, to the extent that, HUD will pay, and require the developer to collect, HAP contract rents that are in excess of the lowest rents allowed by other participating programs (Housing Commission, Home, and Tax Credits), the developer will 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. Should this enhanced project cashflow materialize, repayment of the Commission's loan will be accelerated.

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 4.

The property offers plenty of open space, recreation facilities, laundry facilities, and ample parking. Working closely with its co-managing general partner (Historic San Diego Community Development Corporation), Avalon would provide after-school programs, computer labs, and job placement assistance for the tenants. The non-profit 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% (\$28,450 for a family of four) to 60% (\$34,140 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	\$569	\$625	\$56
1br@60%	600	47	\$625*	\$625	-
2br@50%	795	10	\$640	\$765	\$125

2br@60%	795	84	\$765*	\$765	-
3br@50%	990	5	\$711	\$910	\$199
3br@60%	990	9	\$854	\$910	\$56
3br@60%	1,000	10	\$854	\$910	\$56
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 exists a HAP contract between HUD and the owner. Upon purchase of the property, Logan Square Housing Partners, LP will assume the HAP contract. Also, if, and to the extent that, HUD will pay, and require the developer to collect, HAP contract rents that are in excess of the lowest rents allowed by other participating programs (Housing Commission, Home, and Tax Credits), the developer will 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. There are 14 mature trees that have been planted in close proximity to building foundations and/or sidewalks that will require removal in order to abate uplifting and cracked concrete sidewalks and possible damage to building foundations.

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 systems, plumbing, heating system repairs and cabinetry as needed, any necessary noise attenuation measures to meet federal requirements, and a modernized community recreation room. It is also proposed to retrofit each building lacking a water heater with an independent water heating system, enclosure and circulating pump. Most of the buildings share hot water that is provided by eight 100-gallon water heaters situated at four separate locations.

The cost to rehabilitate this complex has been budgeted by the developer to be \$2,380,000, or \$14,000 per unit. This budget value is appropriate based on review by staff and the developer's proposed improvements. It includes a contingency budget that has been developed to fund 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.

Property Value

The acquisition price is \$9.5 million. The seller of the property is Logan Square Gardens Company, a Limited Partnership represented by Michael D. Colt of Roar Company, the General Partner based in Dallas, Texas.

According to the MAI Appraisal, the "as-is" value is \$9,050,000 and the "after rehab" value is \$10,510,000. Although the acquisition price is higher than the "as-is" value, no Commission funds will be used towards acquisition. Commission funds will only be utilized at rehabilitation completion. Nevertheless, the Commission will require that the deferred developer's fee be subordinate to the Commission loan.

Relocation

The applicant is discussing the project with a relocation consultant to determine if a relocation plan is appropriate. The plan would include relocation of any affected and eligible residents within the existing project. At the time of this report distribution, the actual number of households that may require permanent relocation assistance was not known. However, the developer understands that it is its responsibility to use proceeds from its development fees to pay for any additional relocation costs not currently budgeted. Commission funds will only be utilized at rehabilitation completion. This will be at a point when all relocation expenses will have been paid.

The Funding Request

The total development costs for the project is estimated to be \$15,769,214. The first position funding will be tax-exempt permanent bond financing in the amount of \$9,800,000 utilizing Federal National Mortgage Association ("Fannie Mae") credit enhancement. Total loans against the property would be \$10,800,000. It additionally assumes a 4% tax credit issued by the California Tax Credit Allocation Committee (CTCAC) in the approximate amount of \$4,141,166. The developer will provide \$828,048 in deferred fees.

The 3% interest, \$1,000,000 Commission loan will be amortized over 55 years and secured by a second trust deed against the property. The Commission loan will be due one year following the payoff of the first position loan (a 30-year loan). Until year 2016, the payment of the Housing Commission's debt will be the lesser of the amortized payment or 50 percent of the cash flow following payment of the first position note debt payments and operating expenses of the property. The minimum annual payment will be \$49,043, which is equal to half of the estimated residual receipts at year one (subject to the acceptance by the primary lender and its lending requirements.) Beginning in the year 2016, in the event that there have been any shortfalls in payments not made up in

the preceding years, the Housing Commission loan would be re-amortized over the remaining term of the loan to ensure the payoff.

In the event that the Fannie Mae bond amount experiences an increase, there will be a commensurate reduction in the Commission loan amount to the borrower.

The Financial Plan

Total Development Cost	The total development cost is \$15,769,214, which includes the purchase price, and other development costs.
Appraised Value:	The "as-is" value is \$9,050,000 and the "after rehab" value is \$10,510,000.
Security:	The Housing Commission loan will be secured by a second trust deed against the property.
Loan-to-Value:	The after-rehab loan to value is 103%.
Debt Service Ratio:	The debt service ratio on the first trust deed in the first year is 1.13.
First Trust Deed:	A fully amortized tax-exempt permanent loan of at least \$9,800,000 will be in first position with a term of 30 years and a 6.35% interest rate.
Second Trust Deed:	Housing Commission funds; 3% simple interest.
Payments on the Second Trust Deed:	The payment of the Housing Commission's debt will be the lesser of the of the amortized payment or 50% of the cash flow following payment of the first position note debt payments and operating expenses of the property. The minimum annual payment will be \$49,043, which is equal to half of the estimated residual receipts at year one (subject to the acceptance by the primary lender and its lending requirements.) Beginning in the year 2016, in the event that there have been any funding shortfalls in payments not made up in the preceding years, the Commission loan

would be re-amortized over the remaining term of the loan to insure the payoff.

In the event revenue sources such as Interest Reduction Payments or other forms of governmental subsidies contribute to the cash flow of the project, the Housing Commission's loan payments will be accelerated accordingly.

Rent Restrictions:

A Declaration of Covenants and Restrictions with a 55-year term will be recorded against the property. 10% or 17 of the units will be affordable to households earning 50% of area median income (AMI) or less. 153 of the units will be restricted to households earning 60% of AMI or less.

Occupancy Restrictions:

Occupancy of 170 units will be restricted to families earning no more than 60% of AMI. 10% (17 units) will be restricted to families earning no more than 50% MAI, with remaining units restricted for families earning nor more than 60% MAI. One unit will be designated for an on-site manager.

Recourse:

The loan will be a recourse loan during the construction period. Once the tax credit financing is in place, the loan will be non-recourse as provided for in the Housing Commission lending policy.

Term:

Thirty-one years (amortized over 55 years).

Management Plan:

A Management Plan has been submitted for approval.

Operating Expense:

Average operating expense of \$287 per unit per month includes a replacement reserve.

Pro Forma Assumptions:

Income increases are projected at 2.5 percent per year; expense increases are projected at 3.5 percent per year; vacancy is projected at 5.0 percent per year.

Risks and Mitigations

Initially, the amount of the loan that exceeds "After-Rehab" value will be uncollateralized. However, the risk level is considered to be low as it is mitigated by conservative proforma assumptions, rents below market, and a 1.13 debt service ratio that is higher than the Commission minimum ratio of 1.05. The operating proforma includes replacement reserves to help protect the project's condition and performance in future years.

The Bonds, which are expected to be credit enhanced by Federal National Mortgage Association ("Fannie Mae"), are expected to receive the highest possible rating of AAA. The Bonds will 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 will 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 project revenue sources.

Staff has been working with CSG Advisors, Inc., the Housing Commission's Financial Advisor on 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 financings and public benefits to be achieved, it is the Financial Advisor's recommendation that the bond issuance for the project be authorized. The Financial Advisor's analysis and recommendation to proceed is included as Attachment 5.

To date, neither the equity investor, the credit enhancer, nor the construction lender have issued their final commitment to the project. The Bonds will not be issued, and the Housing Commission loan will not close, without these funding commitments.

Finally, this potential property acquisition is strengthened by the applicant's real estate experience and portfolio record with similar types of projects.

ALTERNATIVE

The Housing Commission could decline to recommend this gap loan and Bond financing. The project's bond allocation will automatically revert to the State unless the Bonds are issued by November 20, 2001. Without the benefit of the loan and 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.

For the Agenda of October 30, 2001

Loan and Final Authorization to Issue Housing Revenue Bonds for Logan Square Apts.

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Respectfully submitted,

**Signature on File
With Original Document**

Approved by,

Pat Duplechan
Director, Housing Programs

Elizabeth C. Morris
Chief Executive Officer

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- Attachments:
1. Housing Commission's Multifamily Bond Program
 2. Developer's Disclosure Statement*
 3. Information on the Non-Profit Managing General Partner
 4. Project Location Map
 5. Financial Advisor's Letter
 6. Project Development Summary
 7. SDHC Development Forms
 8. Financial Statements*
 9. Rehabilitation Cost Estimate*
 10. Appraisal*

*Distribution of this attachment is limited. A copy is available for review at the Housing Commission's 1625 Newton Avenue office and at the Office of the City Clerk, 2nd floor, 200 "C" Street.

ATTACHMENT 1

HOUSING COMMISSION'S MULTIFAMILY BOND PROGRAM

General Description

The Housing Commission's 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 actual issuer of the Bonds is the Housing Authority. At the present time, nearly \$480 million in outstanding Bonds provide permanent financing for over 8,000 multifamily rental units in the City, of which more than 3,400 units are restricted at various levels of affordability.

The Housing Commission's policy for the issuance of Bonds requires 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.

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 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. Some projects require both forms of assistance.

The authority to issue Bonds is limited under the US Internal Revenue Code. The California Debt Limit Allocation Committee (CDLAC) accepts applications generally twice a year (funding "rounds"). The state's bonding capacity is \$62.50 per capita this year and will increase to \$75 per capita 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 to 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 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 for-profit developers or 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 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, information about the proposed tax-exempt financing of the project is preliminary. After the inducement resolution is approved, a due diligence process conducted by staff and financing team members generates 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.