



Good Neighbors

San Diego
Housing Commission

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REPORT

DATE: For the Agenda of November 9, 2001

ITEM 107

REPORT NO: HCR01- 126

SUBJECT: Loan and Final Authorization to Issue Multifamily Housing Revenue Bonds for Island Village Apartments (Council District 8)

SUMMARY

Issue No. 1: Should the Housing Commission recommend that the Housing Authority facilitate development of 280 rent restricted living units in East Village by taking final steps to issue bonds and authorizing a loan to a new partnership, Island Palms Apartments, L.P. (IPA)?

Recommendation No. 1: That the Housing Commission recommend that the Housing Authority:

- (a) authorize the issuance of up to \$11,000,000 in tax-exempt housing revenue bonds to replace Bond Anticipation Notes that mature on December 31, 2001, and to provide permanent financing to Island Palms Apartments, L.P. to acquire and construct the 280-unit Island Village Apartments located at 1245 Market Street in Downtown San Diego;
- (b) 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 financing; and,
- (c) approve a three percent residual receipts Housing Commission loan of \$1,300,000 (in addition to the \$2,300,000 loan previously approved, for a total loan of \$3,600,000) to Island Palms Apartments, L.P. to finance the construction of Island Village Apartments.

Issue No. 2: Should the Housing Commission approve and recommend Housing Authority approval to amend the Commission's Fiscal Year 2002 budget, adding \$1,300,000 of CCDC Low and Moderate Housing Set-Aside Funds for rental housing loans?

Recommendation No. 2: It is so recommended.

Fiscal Impact: The 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 annual fee for administering the bonds would be up to \$28,290 (0.23 percent of the total bond amount).

Approval of the loan and budget amendment would result in the expenditure of up to \$1,300,000 of CCDC Low and Moderate Housing Set-Aside Funds for rental housing loans. This is in addition to the \$2,300,000 in HOME Program funds and Housing Trust Funds already committed to the project.

Previous Related Actions: A Bond Inducement resolution, a TEFRA resolution and an application for the allocation of bond issuing authority for the project was recommended by the Housing Commission on January 19, 2001 (Report No. HCR 01-014) and approved by the Housing Authority and City Council on February 13, 2001 (Resolution No. R-1086 and Resolution No. R-294604). On June 22, 2001, the Housing Commission recommended Housing Authority approval of: (a) a \$2.3 Housing Commission loan; (b) a \$1.1 million Housing Commission loan application for HELP Program funds; and, (c) an \$11,000,000 tax-exempt, and a \$1,350,000 taxable, bond issuance. The Commission also recommended City Council approval of a new TEFRA resolution (Report No. HCR 01-077). The Housing Authority and City Council convened on July 31, 2001 and approved the following recommendations contained in a supplemental Housing Commission report: (a) a \$2.3 Housing Commission loan; (b) a \$1.1 million Housing Commission loan application for HELP Program funds; (c) issuance of \$11,000,000 in interim tax-exempt Notes; and (d) a new TEFRA resolution (Resolution No. R-1116; Resolution No. R-1116; and, Resolution No. R-295249).

Future Related Action: If the recommendations are approved by the Housing Commission, final approval to issue the bonds and provide for an additional Housing Commission loan to the project would be sought at the next available Housing Authority meeting.

Affordable Housing Impact: During the lease-up period, 84 of the 280 units (30 percent of the units) would be affordable and restricted to households with incomes at or below 50 percent of median area income (MAI) and 196 (70 percent of the units) would be affordable and restricted to households with incomes at or below 60 percent of MAI. Following complete lease-up, rents for 40 of the 196 units restricted at the 60 percent level would be frozen, with no yearly increases, until equivalent to rents at the 50 percent level. As the initial tenants move out of the 40 units with frozen rents, those units would become restricted at the 50 percent level and rented

only to residents with incomes at or below 50 percent MAI. Restricted rents would also apply if Section 8 tenants occupy the units.

The following is an outline of estimated initial rents for the proposed development:

Unit Size	No. of Units	Rent Levels @ 50% of MAI	Rent Levels @ 60% of MAI	Estimated Market Rate Rents	Estimated Rent Savings Annually
studio	197*	N/A	\$597	\$664	\$157,584**
studio	84	\$497	N/A	\$664	\$168,336
Total	280				\$325,920

* Includes one manager's unit

** Excludes one manager's unit

HOME Program Compliance: A loan to a nonprofit corporation for construction of multi-family rental housing is an eligible activity under the HOME Program. The proposed rents are below HOME guidelines. Of the 280 units, 11 would be HOME-funded.

Environmental Review: A Negative Declaration ("NegDec"), pursuant to the California Environmental Quality Act (CEQA), and a Finding of No Significant Impact (FONSI), pursuant to the National Environmental Policy Act (NEPA), have been completed for the proposed development. HUD has certified the adequacy of the FONSI and has authorized the release of HOME funds.

BACKGROUND

The proposed Island Village Apartments is designed to address the need for affordable rental housing to single low-income adults working downtown. The resident population targeted by the proposed development typically relies on low cost single-room-occupancy (SRO) hotels for housing. An estimated 4,100 existing SRO units in San Diego operate at or near capacity. Approximately 400 of these units are scheduled to be demolished for courthouse development.

On February 21, 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 \$11,000,000. On May 8, 2001, CDLAC awarded the requested bond allocation to the project. The project's bond allocation would have automatically reverted to CDLAC unless the bonds were issued by August 13, 2001. Subsequent to the Housing Commission's meeting on June 22, 2001, and due to a change in the identity of the proposed ownership entity, the source of the bonds' credit enhancement, Federal National Mortgage Association ("Freddie Mac"), announced that it would not be able to deliver the credit enhancement prior to the expiration of the bond allocation on August

13th. To preserve the allocation for the project, the Housing Authority, at its meeting on July 31, 2001, approved an interim issuance of \$11,000,000 in Multifamily Housing Revenue Bond Anticipation Notes, which mature on December 31, 2001.

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 a bond financing, is described in Attachment 1.

DISCUSSION

The Borrower

The developer and proposed owner of Island Village Apartments is Island Palms Apartments, L.P. (IPA), a limited partnership. The partnership has changed since the initial approval of the bonds. It now includes Barone Galasso & Associates, Inc. (BGA) -- BGA replaces JMI Realty -- as the general partner, and the Housing Commission's non-profit, Housing Development Partners (HDP), as the managing general partner. IPA will also consist of a tax-credit equity investor serving as the limited partner. Island Village Apartments is the first development for IPA and would be the organization's sole asset.

BGA is a for-profit corporation that specializes in the development and operation of affordable housing. The company has developed over 1,460 units of affordable housing since its establishment in 1986. In 1999, BGA was the Managing General Partner for 33rd Street Family Housing Partnership, the developer of the 40-unit Vista Verde Apartments development financed with a loan of approximately \$1.2 million from the Commission. Mr. Michael B. Galasso, president, supervises BGA's development activities in San Diego. Since IPA is a fledgling organization, BGA's financial statements were reviewed by staff and found to be satisfactory. (See Applicant Financial Statements - Attachment 7.) BGA provides property management for its developments and for the developments of other housing providers. BGA's management staff includes experts in marketing, regulatory, and logistical issues related to the operation of affordable housing. BGA currently manages over 700 rental-housing units.

The Development

Island Village Apartments would be located on an approximately one-acre parcel at the south side of Market Street between 12th Street and 13th Street. The development would be within the Ballpark District, a redevelopment area under the planning jurisdiction of Centre City Development Corporation. The construction area of the proposed ballpark is approximately five blocks south of the Island Village Apartments site. (See Location Map - Attachment 2.)

Existing improvements to the proposed development site consist of light commercial and industrial businesses, and the historic Palm Hotel. The Island Village parcel and the 77-unit Palm Hotel SRO are owned by Palm Village, LLC. IPA plans to purchase the Palm Hotel with the Island Village site and renovate it as a later phase of the Island Village complex.

Island Village Apartments would consist of 280 furnished rental housing units and 3000 square feet of commercial lease space in one four-story building. One of the restricted units would be used as a resident managers apartment. The design of the exterior elevations avoids a monolithic appearance through various combinations of setbacks, awnings, and other architectural details. The building would have a landscaped interior courtyard with a fountain. Parking would be provided in an underground garage beneath the building.

The proposed apartments, classified as "living units" by San Diego Municipal Code Section 103.1959, would be larger and have more amenities than typical SRO units. Each apartment would have a bathroom, and a kitchen equipped with a cook top, an oven, a sink with a garbage disposal, and a small refrigerator. The units differ from a standard studio apartment because they are slightly smaller, with main living areas of approximately 150 square feet rather than the over 200 square feet of a typical studio. Maximum allowable occupancy for the proposed units would be two persons.

The Funding Request

The total development cost is estimated at \$21,500,000 (approximately \$76,786 per unit). The financing sources include an \$11,000,000 allocation of tax-exempt bonds; four percent low-income housing tax credits of \$6,030,000; \$496,500 in equity contribution from the JMI Realty, the master developer for the block on which the Island Village development will be located; \$110,000 in forward commitment fee refund; \$262,000 in deferred developer's fee; and \$3,600,000 from the Housing Commission.

The Housing Commission's loan includes \$1,300,000 in Low and Moderate Housing Set-Aside Funds from CCDC. Councilmember Toni Atkins had asked CCDC to consider providing these funds to the project to replace funds that were anticipated to be provided by the Housing Commission through the California Housing Finance Agency (CHFA) Housing Enabled by Local Partnerships (HELP) Program.

The CCDC fund transfer would consolidate the local contribution to the project in one loan and allow for timely closing of all funding sources. Following construction and lease-up of the project, the Housing Commission will pursue taxable bonds for the project and use proceeds from the bond issuance to repay CCDC. Should the taxable bond issuance not cover the entire \$1.3 million, CCDC would accept a short payment. Commission funds would not be used for the commercial portion of the Island Village development. The Commission would subordinate to other lenders as necessary.

The Financial Plan

Total Development Cost:	The estimated total development cost of \$21,500,000 includes the value of the land, construction, interest costs, builder overhead and profit, builder fees, and a developer fee.
Cost per Unit:	The estimated cost per unit is \$76,786, which includes the parking garage.
Appraised Value:	The "as-built" appraised value of the property is \$14,500,000. The total loan to value is 101%.
Loan Amount:	The requested Housing Commission loan would leverage \$3,600,000 against \$17,900,000 expected from other sources.
Security:	The Commission loan would be secured by a second position trust deed recorded against the property.
Rent Restrictions:	A Declaration of Covenants, Conditions, and Restrictions with a 55-year term of affordability would be recorded against the property.
Occupancy Restrictions:	A restriction limiting occupancy of 196 units to households earning 60 percent or less of MAI and a restriction limiting occupancy of 84 units to households earning 50 percent or less of MAI would be recorded against the property. In addition, rents for 40 units initially restricted at 60 percent of Area Median Income would be frozen until they meet the 50 percent affordability level; following move-out by the initial tenants, they would become restricted at 50 percent of Area Median Income.
First Trust Deed:	An estimated \$11,000,000 Tax Exempt Bond. The bonds will be sold through a public sale with Newman and Associates serving as the underwriter. These bonds are being underwritten with credit enhancement provided by Freddie Mac, which is expected to receive the highest possible rating of AAA.

Second Trust Deed:	<p>A \$3,600,000 55-year residual receipts loan at three percent interest per year from the San Diego Housing Commission.</p> <p>Should the Housing Authority, at a future date, issue up to \$1,300,000 in taxable bonds, that debt would be secured by a second trust deed. The Housing Commission debt, which would be reduced by the same amount of taxable bonds, would then be secured by a third trust deed.</p>
Equity Investment:	<p>An estimated \$6,030,000 Tax Credit Investment.</p>
Payment Terms:	<p>Amortized over 55 years, due one year following the payoff of the first position loan. Until year 2016, the payment of the Housing Commission's debt will be the lesser of the amortized payment or 75 percent of the cash flow following payment of the first position note debt payments and operating expenses of the properties. Beginning in the year 2016, in the event there have been any shortfalls in payments not made up in preceding years, the Housing Commission loans would be re-amortized over the remaining term of the loan.</p>
Recourse:	<p>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.</p>
Management Plan:	<p>Staff has reviewed and approved IPA's management plan.</p>
Operating Expense:	<p>Monthly operating expense is projected at \$249 per unit.</p>
Replacement Reserves:	<p>A reserve of \$69,996 per year / \$250 per unit.</p>
Pro Forma Assumptions:	<p>Income increase projected at 2.5 percent per year; expense increase projected at 3.5 percent per year; and vacancy projected at 5 percent per year.</p>

Risks and Mitigation

Staff has been working with Dain Rauscher, Inc., the Housing Commission's financial advisors, 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 for the project be authorized. The Financial Advisor's analysis and recommendation to proceed is included as Attachment 8.

Issuance of the bonds would be contingent upon IPA arranging the other financing. 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 Purchase Agreement. All bond documents in a substantially final form will be on file in the Housing Commission offices at the time of docketing for consideration by the Housing Authority.

Loans to tax credit developments become non-recourse upon the creation of a limited partnership for tax credit syndication because of Internal Revenue Service regulations that make the investment undesirable if structured otherwise. This would limit the Commission's ability to recover funds because the encumbrance would be only on the property and not the other assets of the developer. This risk is typically taken by the Commission for tax credit-financed developments, and is deemed mitigated by conservative underwriting assumptions.

Representing less than 17% of the project's total estimated development cost, the Commission loans also would be contingent upon IPA arranging the other financing. This contingency, coupled with the development experience of the project management team, makes this a relatively low-risk investment.

ALTERNATIVE

Do not authorize the issuance of the bonds. The \$11,000,000 in Multifamily Housing Revenue Bond Anticipation Notes will mature on December 31, 2001. Without the benefit of the tax-exempt bonds and the accompanying four percent tax credits, the project will become financially infeasible.

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Approve a recommendation for a Housing Commission loan of less than the proposed additional \$1,300,000, or decline loan approval. Since the other lender commitments are based on IPA securing gap funding from the Commission, a decision to not approve the loan, or to loan a lesser amount, could result in the withdrawal of the proposal and the resulting loss to the City of 280 affordable units for low-income renters.

Submitted by,

**Signature on File
with Original Document**

Approved by,

Pat Duplechan
Director, Housing Programs

Elizabeth C. Morris
Chief Executive Officer

Attachments:

1. Description Bond Program and Actions to be Taken
2. Location Map
3. Project Development Summary
4. Development Timeline
5. HC Development Form
6. Disclosure Statement*
7. Financial Statements*
8. 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.

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 these bonds is the Housing Authority. At the present time, nearly \$470 million in outstanding bonds provides permanent financing for more than 7,900 multifamily rental units in the City, of which 3,203 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"), 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 this year and \$75 in 2002.

The Housing Authority benefited from this increase, as evidenced by its recent receipt of bond allocation authority from CDLAC for six of seven first round applications submitted on February 21, 2001.

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 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 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.

ATTACHMENT 3

Development Summary

June 22, 2001

Name: Island Village Apartments
Location: 1245 Market Street
Description: Rental housing for low income residents
Sponsor: Island Palms Apartments, L.P.

Unit Affordability

Total # of units: 280
Assisted units: 280
Restricted rents: studios @ \$597
studios @ \$497
Market rent: studios @ \$664

Percent of MAI: 196 units @ 60 percent
84 units @ 50 percent

Affordability: 55 years

Development Cost

Total development cost: \$21,500,000
HC development cost: \$ 3,600,000
Total development cost per unit: \$ 76,786
HC cost per unit (280 units): \$ 12,857
HC subsidy per bedroom @ 280 br's: \$ 12,857

Sources of Funds

Tax Exempt Bond \$11,000,000
Low Income Housing Tax Credits \$ 6,030,000
San Diego Housing Commission Loan \$ 3,600,000
Developer Equity \$ 607,704
Deferred Developer Fee \$ 262,296

Pro Forma Summary

Estimated net annual income: \$ 1,072,332 (year 1)
Estimated annual expense: \$ 836,484 (year 1)
Annual debt service: \$ 817,044 (1.31 ratio in year 1)
Estimated residual receipts: \$ 255,288 (year 1)
Est. cumulative residual: \$ 5,832,559 (year 15)

ATTACHMENT 4

Island Village Apartments DEVELOPMENT TIMELINE

June 22, 2001	Loan (\$2,300,000) to the Housing Commission for approval
July 17, 2001	Loan (\$2,300,000) to the Housing Authority for approval
November 9, 2001	Loan (\$1,300,000) to the Housing Commission for approval
November 27, 2001	Loan (\$1,300,000) to the Housing Authority for approval
December 14, 2001	Construction Loan Closing
January 14, 2002	Start of Construction
September 30, 2002	Certificate of Occupancy
February 21, 2003	Complete Occupancy / Stabilization
March 21, 2003	Permanent Loan Closing