Good Neighbors
San Diego
Housing Commission

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REPORT

DATE: For the Agenda of December 14, 2002 **ITEM 105**

REPORT NO: HCR01-138

SUBJECT: Supplemental Multifamily Housing Revenue Bonds to Complete Construction of Hollywood Palms Apartments (Council District 3)

SUMMARY

Issue #1: Should the Housing Commission consider subordinating its $2,200,000 loan to Hollywood Palms to a larger tax-exempt indebtedness during construction?

Recommendation #1: That the Housing Commission authorize the subordination of its $2,200,000 loan to Hollywood Palms for additional tax-exempt bonds during construction if the bonds are fully-secured with a bank letter of credit, and meet the Commission's underwriting standards.

Issue #2: Should the Housing Commission recommend that initial steps be taken toward issuance of supplemental tax-exempt revenue bonds to complete the construction of the 94-unit Hollywood Palms Apartments located at 4366 Home Avenue, San Diego, CA 92105?

Recommendation #2: That the Housing Commission recommend:

1) the Housing Authority approve a bond inducement resolution ;
2) the Housing Authority approve an application for bonding authority for Round 1 and, if necessary, subsequent rounds (up to three rounds) of the State's 2002 allocation rounds;
3) the City Council hold a public hearing ("TEFRA" hearing) and adopt a resolution approving the issuance of bonds in the approximate amount of $1,500,000 for the project; and
4) approve Joe Litten as financial advisor, Stradling Yocca Carlson & Rauth as bond counsel and Newman & Associates, Inc. as bond underwriter (the same financing team that structured the initial bond issuance).

Fiscal Impact – No other Housing Commission funds are required, however the amount of debt in front of the Housing Commission's $2.2 million loan will increase by an estimated $1,250,000 (the amount of the bond issuance) during construction.

Debt service coverage is not affected as the bonds are only outstanding during construction. Boston Capital will make the interest payments on the bonds while they are outstanding. Approval of the resolution does not commit the Housing Authority to issue bonds. The developer is responsible for the payment of all costs under the financing.

Housing Affordability Impact – 90% percent of the project (85 units) is to be set aside for occupancy by low-income tenants earning 60 percent or less of the area median income ($34,140 for a four-person household) for 55 years. The remaining ten percent of the units (9 units) will be set-aside for occupancy by very low-income tenants earning 50 percent or less of the area median income ($28,450 for a four-person household) at rents restricted at the corresponding affordability level for 55 years. The rent schedule for the project proposed by the applicant is included as part of the project description.

Previous Related Actions – The Housing Commission and Housing Authority considered issuance of bonds and a Housing Commission loan to this project at numerous public hearings, beginning in March, 2001. On July 17, 2001, the Housing Authority authorized the issuance of bonds in the amount of $7,000,000, a Housing Commission loan of $2,200,000, and the execution of project-based Section 8 contracts for 23 units (HA Resolution No. 1111).

Future Related Action(s) - A specific authorization to issue additional bonds for the project will be sought from both the Housing Commission and the Housing Authority at future dates.

BACKGROUND

The previously approved Housing Commission loan and bond financing for this project closed on August 9, 2001. Shortly after the close of escrow, the original construction contractor failed to perform in accordance with the contract terms and the contract was terminated.

The developer, Affirmed Housing Group, was forced to pursue a new construction contractor, and signed a new construction contract with Wermer's Construction. Because construction could not be continued and completed under the original contract, additional expenses have been incurred, including but not limited to the payment of outstanding invoices to previous subcontractors, costs associated with delay of the construction, and the added cost of having another contractor come on to the site to correct some items, obtain all previous inspection records and continue with the work needed to be done to complete the project.

Expenses for the project have increased by $2.6 million. The limited partner, Boston Capital, has committed to cover the balance of extra costs, but has requested an additional issuance of tax-exempt bonds. The additional tax credit equity allowed by these bonds will substantially cover the additional permanent funding gap. The bonds will be short-term (approximately 9 months), and will be retired by Boston Capital's equity contribution to the project. During the time the bonds are outstanding (during construction), Boston Capital will pay all interest payments. Additional tax credit equity, in the approximate amount of $1,200,000 can also be obtained under this scenario, due to the additional eligible costs.

As has been noted previously, 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 receives more applications than is available under its financing authority. Despite recent congressional action that has increased the state's bonding capacity by 50%, competition is expected to remain keen.

The first CDLAC funding round of 2002 is expected to be in late January. In order to meet the CDLAC application deadlines, the owner has requested that the Housing Authority adopt an inducement resolution, and that a TEFRA hearing by the local jurisdiction be held.

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

<u>Financing Structure</u>

The project will be owned under a limited partnership, San Diego/Fox Hollow, LP. Affirmed Housing Group is the General Partner responsible for completion of the development. City Heights Community Development Corporation, the nonprofit partner of Affirmed, is the Managing General Partner. Boston Capital is the investor limited partner.

The project is under construction and is approximately 50% complete. Old project costs of $14,309,186 have now been revised. The new total development cost is $16,866,520, an increase of $2,557,334. Increased construction costs account for approximately $1.75 million of the increase ($1.1 of hard construction costs, $250,000 in lien payments and a construction contingency required by the bank of $400,000). Other soft cost increases include $60,000 in increased architectural and engineering, an additional $200,000 in construction loan interest, a $327,613 construction loan origination fee, $54,000 of additional fees due to permit expirations Increased bond issuance, bank and insurance costs account for another $165,721.

The additional issuance of bonds, in the approximate amount of $1,250,000 would partially fund this amount, with the balance being made up by additional 4% tax credit equity and an increased equity contribution by the limited partner, Boston Capital.

The old and new project sources and uses are shown as follows:

Sources of Financing	*Old Budget*	*New Budget*
Tax Exempt Bonds	$6,590,000	$6,550,000
Additional Bonds		$1,250,000*
Tax Credit Equity	$4,198,000	$5,412,748
Partnership Contribution	$1,321,000	$1,453,772
Housing Commission Loan	$2,200,000	$2,200,000
TOTAL SOURCES	$14,309,186	$16,866,520
Uses of Funds		
Land	$850,000	$850,000
Construction Costs	$8,107,520	$9,871,398
Project Soft Costs	$4,151,666	$4,945,122
Developer Fee	$1,200,000	$1,200,00
TOTAL COSTS	$14,309,186	$16,866,520
Loan to completion value	121%	138%

*Outstanding only during construction. At completion of construction, the partnership contribution will increase by this amount to pay off the bonds.

It is anticipated that the bond-financed loan will be underwritten utilizing a bank letter of credit resulting in a minimum of an “A” rating of the bonds. Should the Housing Authority authorize the issuance of bonds for the project in the future under a separate action, 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 Authority would be pledged to the payment of the bonds because the security for the bond repayment is limited to the value of the property and the project revenue sources. The developer is responsible for the payment of all costs under the financing, including the Housing Commission's annual fees.

Project Narrative

Fox Hollow Apartments is a 94-unit new construction project located at 4366 Home Avenue. The project was approved by the City Council in 1987, and development entitlements were vested with City Council approval of the Final Map in 1992. The project received 9% tax credit financing in 1998. Development permits were obtained and construction began in late summer 2000. Because the project could not be placed in service by the December 31, 2000 deadline established for the tax credit financing, the tax credits were forfeited and financing was withdrawn. Construction of the project is approximately 50% complete.

The owner/developer determined that in order to complete the project and preserve the affordability, the clearest course was to restructure the project and finance the project with tax-exempt debt and 4% tax credits. After substantial community testimony, the City Council on April 17, 2001, voted 7 to 1 to support the application for bond financing. Councilmember Atkins committed to be personally involved in the progress of the project to ensure the community concerns were addressed.

As a result of the ongoing discussions between the new development team and community leaders, a number of changes to the project were made and include enhancements to the project design, site work and landscaping. The project financing was approved on July 17, 2001, and closed on August 9, 2001.

Selection of the Financing Team Members

The financing team members for the proposed financing 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 among the firms previously selected through a competitive RFP process. The recommended financing team is: Joe Litten as financial advisor, Stradling Yocca Carlson & Rauth as bond counsel and Newman & Associates, Inc. as bond underwriter. The same financing team that has structured the financing up to this point is recommended for the additional bond financing.

Rents and Affordability Levels

Ninety percent of the project (85 units) is to be set-aside for occupancy by low-income tenants earning 60 percent or less of the area median income ($34,140 for a four-person household) for 55 years. The remaining ten percent of the units (9 units) will be set-aside for occupancy by low-income tenants earning 50 percent or less of the area median income ($28,450 for a four-person household) at rents restricted at the corresponding affordability level for 55 years.

HOLLYWOOD PALMS APARTMENTS

Type	Sq. Ft.	AMI	Number of Units	Average Current Rents*	Maximum Rent Paid by Tenant	Market Rate	Savings
2 Bedroom	820	50% AMI	4	NA	$591	$943	$352
3 Bedroom	1,050	50% AMI	10	NA	$651	$1138	$487
4 Bedroom	1,200	50% AMI	7	NA	$693	$1415	$722
2 Bedroom	820	60% AMI	40	NA	$719	$943	$224
3 Bedroom	1,050	60% AMI	18	NA	$794	$1138	$344
4 Bedroom	1,200	60% AMI	15	NA	$847	$1415	$568
Total			94				

* New construction; no existing rents available

RISKS AND MITIGATIONS

If approved, the Housing Commission's loan will be subordinate to another approximately $1,250,000 of tax-exempt debt. This increases the loan to value, including the Housing Commission's loan, from 121% to 138%. Prior to requesting approval to issue bonds the project would undergo a feasibility analysis, and Boston Capital would have to provide a bank letter of credit that would fully guarantee the additional bond debt.
Approval of the resolutions does not commit the Housing Authority to issue bonds. The recommended actions do not represent any commitment by the Housing Commission, Housing Authority or the applicant to proceed with the tax-exempt financing of the project.

ALTERNATIVE

Do not recommend approval of the TEFRA resolution. If the recommended actions are not taken, the project will not be able to benefit from the additional tax-exempt below-market financing. If the request for additional bond financing is not approved, the investor limited partner, Boston Capital, has committed to invest the additional funds necessary to complete the project.

Respectfully submitted, Signature on File With Original Document Approved by,

Jack D. Farris
Housing Finance & Development Manager

Elizabeth C. Morris
Chief Executive Officer

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Attachments:
1. Bond Program Description and Actions to be Taken
2. Developer's Statement for Public Disclosure
3. Project Location Map
4. Development Timeline

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 $400 million in outstanding bonds provides permanent financing for more than 6,900 multifamily rental units in the City, of which 2,373 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.

Actions that must be taken by the Housing Authority and by the City Council to initiate 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. In the case of the Fox Hollow Apartments, the California Statewide Communities Development Authority will issue the inducement resolution and will subsequently transfer its resolution to the San Diego Housing Commission.

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 4

DEVELOPMENT TIMELINE

• Loan Committee	June 13, 2001
• Housing Commission	June 22, 2001
• Housing Authority	July 17, 2001
• Loan & Bond Closing	August 9, 2001
• Estimated Completion of Construction	February, 2002
• Estimated Full Occupancy	May, 2002