The Housing Authority of the City of San Diego

DATE: For the Agenda of January 15, 2002

REPORT NO: HAR02-001

SUBJECT: Multifamily Housing Revenue Bonds for Two New Projects Within Subareas III and IV of the North City (Council District 1)

SUMMARY

Issue No. 1: Should the Housing Authority and City Council take the initial steps to issue tax-exempt and taxable housing revenue bonds to finance the acquisition and construction by Chelsea Investment Corporation of two projects located in subareas III and IV of Council District 1, formerly a part of the North City Future Urbanizing Area (NCFUA)?

Recommendation: No. 1: That the:

A. Housing Authority approve Bond inducement resolutions for the following two projects, totaling 58 affordable units:

   1. Acquisition and construction of the 32-unit Villa Andalucia Apartments complex to be located in Pacific Highlands Ranch (subarea III) at the intersection of Rancho Santa Fe Farms Road and Caminito Mendiola for the approximate amount of $2.5 million in housing revenue bonds (Council District 1);

   2. Acquisition and construction of the 26-unit Villa Glen Apartments to be located in Torrey Highlands (subarea IV) on Torrey Santa Fe Road west of Torrey Meadows Drive for the approximate amount of $2.3 million in housing revenue bonds (Council District 1).

B. Housing Authority approve applications to Round 1 and, if necessary, subsequent rounds (up to three rounds) of the State's 2002 allocation rounds for bond issuing authority for both projects; and,

C. City Council hold a public hearing *(known as a TEFRA hearing* -Tax Equity and Fiscal Responsibility Act) and adopt resolutions approving the issuance of bonds by the Housing Authority for both projects.

Issue No. 2: Should the Housing Authority approve financing teams from the previously approved list of Financial Advisors and Bond Counsels to work on preparing the proposed bond issuances?

Recommendation No. 2: That the Housing Authority approve Joe C. Litten as financial advisor and Orrick, Herrington & Sutcliffe, LLP as bond counsel to begin work on both projects.

Fiscal Impact: Approval of the bond inducement resolutions does not commit the Housing Authority to issue bonds. The developer is responsible for the payment of all costs under the financing for the proposed projects.

Housing Affordability Impact: Both projects will restrict 30% of the apartments for occupancy by families earning no greater than 50% Median Area Income (MAI) ($28,450 for a family of four); and the remaining 70% of units for families earning no greater than 60% MAI ($34,140 for a family of four). The affordability restrictions will remain in place for 55 years.

Previous Related Action(s): This action was not scheduled for the Housing Commission Board due to a real or potential conflict of one or more of the Commissioners and potential conflicts of interest under applicable state and local laws. Therefore, the matter is being forwarded directly to the Housing Authority and City Council for action.

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

BACKGROUND

The two projects discussed in this report have not requested loans from the Housing Commission. For as long as the potential conflicts discussed above (“Previous Related Action(s)”) continue to exist, the projects will not be considered for Housing Commission loans. This report pertains specifically to the Housing Authority’s issuance of tax-exempt multifamily revenue bonds.

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

Prior to the CDLAC funding rounds, projects are brought to the Housing Authority and City Council. Bond inducement resolutions must be obtained prior to application submittal and TEFRA resolutions must be secured no later than 30 days after application submittal. The next CDLAC application submittal date is January 23, 2002.

A general description of the 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.

PROJECT NARRATIVES

The applicant and developer for the proposed projects is Chelsea Investment Corporation (Chelsea), which is headquartered in Solana Beach. Mr. James Schmid is President and 100% shareholder of the corporation. Formed in 1986, Chelsea is involved in the acquisition, development, and management of multifamily housing projects in California and Arizona. Chelsea currently manages seven apartment communities, including 689 multifamily units located in San Luis, Arizona and in San Diego, Chula Vista, and Calexico, California. Chelsea and its affiliates own, have developed, or are now developing (not including the proposed projects) 20 apartment projects comprising a total of 2,254 units located in Southern California and Arizona. The Developer's Statement for Public Disclosure is included as Attachment 2.

Chelsea will act as general partner in a partnership that will be created for the projects. Pacific Southwest Community Development Corporation, a California nonprofit public benefit corporation, will serve as the managing general partner and tax credit investors will be the limited partners of the partnership.

The San Diego Housing Commission and Housing Authority have worked successfully with Chelsea over the past two years to issue a total of $8,880,000 in multifamily housing revenue bonds for two developments: $4,100,000 in August of 2000 to assist in the acquisition and rehabilitation of the 100-unit Regency Centre Apartments in Council District 4; and $4,780,000 in July of 2001 to assist in the acquisition and construction of the 76-unit Torrey Highlands Apartments in the Torrey Highlands subarea of Council District 1. Chelsea is also the developer of two 9% tax credit financed projects; the 200-unit senior studio housing, Market Square Manor, and the 90-unit Harvey Mandel Villas for St. Vincent de Paul. The Housing Commission has loans on these two projects totaling $3,590,000. The projects are in Council District 8 and 2, respectively. Finally, Chelsea also recently completed development of the 38-unit Longacres at Seabreaze Farms in the North City.

Chelsea is now requesting that the Housing Authority take the initial steps to issue a total of up to $4.8 million in multifamily housing revenue bonds for the two projects. Development of each apartment complex would fulfill the affordable housing requirements for market rate developments by two separate master developers in the Planning subareas. The location map is included as Attachment 3.

The new construction projects would create a total of 58 units. Each project would include a community facility suitable in size for the number of units in the respective development. Standard unit amenities would include refrigerators, gas ranges, microwave ovens, walk-in closets, and balconies or patios. Both projects would restrict 30% of their units to households earning no greater than 50% of MAI. The remaining 70% of units in each project would be restricted to households earning no greater than 60% of MAI, The restricted rents for each project (outlined below) would also apply if

Section 8 tenants occupy the units. The Regulatory Agreement that determines the level of affordability for the projects would be in existence for 55 years.

Villa Andalucia Apartments

The 32-unit Villa Andalucia Apartments will be located at the intersection of Rancho Santa Fe Farms Road and Caminito Mendiola (south side of State Route 56) in Pacific Highlands Ranch (subarea III) of the FUA. The project, which will be constructed on 1.35 acres, will consist of 8 one-bedroom, one-bath apartments; 12 two-bedroom, two-bath apartments; and 12 three-bedroom, two-bath apartments. The project will include a 1,000 SF community center. Chelsea's development of the project would satisfy the master developer's, Barrett-American, Inc., requirement to provide affordable units on-site, along with the development of market rate housing.

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

Type	**Square Footage**	**MAI**	**Number of Units**	**Average Current Rents**	**Proposed Restricted Rent (minus utility allowance)**	**Market Rate**	**Savings per unit**
1 Bedroom	682	47% MAI	2	N/A	$468	$1,010	$542
1 Bedroom	682	56% MAI	6	N/A	$574	$1,010	$436
2 Bedroom	880	50% MAI	4	N/A	$558	$1,325	$767
2 Bedroom	880	60% MAI	8	N/A	$686	$1,325	$639
3 Bedroom	1,122	50% MAI	4	N/A	$609	$1,602	$993
3 Bedroom	1,122	60% MAI	8	N/A	$752	$1,602	$850
Total:			**32**				

Villa Glen Apartments

The 26-unit Villa Glen Apartments will be located on Torrey Santa Fe Road west of Torrey Meadows Drive (south side of State Route 56) in Torrey Highlands (subarea IV). The project, which will be constructed on 2.2 acres, will consist of 8 one-bedroom, one-bath apartments; 8 two-bedroom, two-bath apartments; and 10 three-bedroom, two-bath apartments. The project features will include a 600 SF community center. Chelsea's development of the project would satisfy the master developer's, McMillin Companies, Inc., requirement to provide affordable units on-site, along with the development of market rate housing.

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

Type	Square Footage	MAI	Number of Units	Average Current Rents	Proposed Restricted Rent (minus utility allowance)	Market Rate	Savings per unit
1 Bedroom	750	47% MAI	2	N/A	$468	$1,010	$542
1 Bedroom	750	56% MAI	6	N/A	$574	$1,010	$436
2 Bedroom	900	50% MAI	3	N/A	$558	$1,325	$767
2 Bedroom	900	60% MAI	5	N/A	$686	$1,325	$639
3 Bedroom	1,091	50% MAI	3	N/A	$609	$1,602	$993
3 Bedroom	1,091	60% MAI	7	N/A	$752	$1,602	$850
Total:			**26**				

SELECTION OF THE FINANCING TEAM MEMBERS

Staff recommends assigning Joe C. Litten as financial advisor and Orrick, Herrington & Sutcliffe, LLP as bond counsel to work on both projects. The proposed financing team members have been selected in accordance with the existing policy for the issuance of bonds. Financial advisors and bond counsels are designated on a rotating basis from the firms selected under the program through a competitive RFP process.

FINANCING STRUCTURE

Chelsea is proposing to combine the two projects into one bond issuance of approximately $4.8 million and duplicate the financing structure used in the Torrey Highlands Apartments project. It is, therefore, anticipated that the bond-financed loan will be underwritten utilizing Federal National Mortgage Association ("Fannie Mae") credit enhancement resulting in a AAA rating of the bonds with equity provided by a tax credit partner. Newman & Associates, Inc. will serve as the projects' Underwriter to market and sell the bonds.

Subsequent to Housing Authority approval, staff would submit, on behalf of Chelsea, an application for private activity bond allocation to the California Debt Limit Advisory Committee (CDLAC). If successful, the bond financing would qualify the projects for the allocation of 4% low-income housing tax credits, which would be sold to a tax credit partner. These proceeds would serve as a contribution of project equity. If the application is unsuccessful, at the request of the developer, staff would resubmit the application for a subsequent round.

In the future, should the Housing Authority, under a separate action, authorize the issuance of bonds for the projects, 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 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.

RISKS AND MITIGATIONS

Approval of the bond inducement resolutions does not commit the Housing Authority to issue bonds. The recommended actions do not represent any commitment by the Housing Authority or the applicant to proceed with the tax-exempt or taxable financing of the projects. When eventually issued, the financing risks associated with each project would be minimal since repayment of the bonds would be guaranteed by a third party.

ALTERNATIVE

Do not recommend approval of the bond inducement and TEFRA resolutions for one or both of the proposed projects. If the recommended actions are not taken for either project, that project will not be able to benefit from tax-exempt below-market financing, and the applicant would not be able to provide the lower than required level of affordability (65% MAI) to each of the three projects.

Respectfully submitted,

Signature on File
With Original Document

Jack D. Farris
Manager, Housing Finance & Development

Approved by,

Elizabeth C. Morris
Chief Executive Officer

ATTACHMENTS:

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

*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 $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.

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 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.