



City of Morgan Hill

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Title: TAX AND EQUITY FISCAL RESPONSIBILITY ACT (TEFRA) HEARING AND CONDUIT FINANCING FOR REHABILITATION OF VILLAGE AVANTE (PARK PLACE) APARTMENTS AFFORDABLE HOUSING PROJECT

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3/1/2017	1	City Council		

CITY COUNCIL STAFF REPORT MEETING DATE: MARCH 1, 2017

PREPARED BY: Rebecca Garcia, Housing Manager
APPROVED BY: City Manager

TAX AND EQUITY FISCAL RESPONSIBILITY ACT (TEFRA) HEARING AND CONDUIT FINANCING FOR REHABILITATION OF VILLAGE AVANTE (PARK PLACE) APARTMENTS AFFORDABLE HOUSING PROJECT

RECOMMENDATION(S)

1. Open/close public hearing consistent with the requirements of the federal Tax and Equity Fiscal Responsibility Act ("TEFRA") and the Internal Revenue Code of 1986, as amended (the "Code"); and
2. Adopt resolution approving the issuance of bonds by the California Municipal Finance Authority ("CMFA") for the benefit of Ecumenical Association of Housing, Inc. ("EAH"), or a subsidiary or affiliate thereof (the "Borrower"), to provide for the financing of the Village Avante (Park Place) Apartments Affordable Housing Project.

COUNCIL PRIORITIES, GOALS & STRATEGIES:

Ongoing Priorities

Maintaining fiscal responsibility
Supporting youth
Preserving and cultivating public trust

2017 Strategic Priorities

Inclusiveness

Regional Initiatives

REPORT NARRATIVE:

The City has been asked to hold a hearing under the federal Tax Equity and Fiscal Responsibility Act ("TEFRA") to determine whether the Village Avante Rehabilitation project should be allowed to issue tax exempt bonds to fund the project. Approval by the City is required under Section 147(f) of the Internal Revenue Code of 1986. This action has no fiscal impact on City funds. The City is holding the TEFRA Hearing needed for approval of issuance of bonds by CMFA. The City is not issuing bonds or assuming any financial obligations.

Village Avante Rehabilitation project, approved via a TEFRA hearing one year ago, is temporarily in a holding pattern as new tax credit investors are solidified. Construction plans are complete and building permits have been issued.

Immediately after the November 2016 election, the tax credit investor market was fueled by speculation of a much lower corporate tax rate expected from the Federal Government. This caused tax credit investors nationwide to pause, seeking clarification about the value of the tax benefit they had hoped to receive as part of the Low Income Housing Tax Credit Program. This is the program used to refinance and rehabilitate most of California's affordable housing, and specifically Village Avante (now renamed Park Place). EAH is optimistic that they will identify an investor for the transaction, but now expect this project to close in the Spring/Summer of 2017, and the construction work would follow shortly after. The Council previously received this report and held a TEFRA hearing for the issuance of the bonds on January 20, 2016. The 2016 approval expired, so a new approval must be granted for the bond issuance.

To date, the structure of the transaction has remained unchanged; however, as the unknown financing dynamics continue to unfold, staff is expecting to return to City Council to discuss potential modifications to EAH's original proposal to pay off up to 13% of the outstanding balance (including principal and accrued interest) of the second position loan from the City (original loan principal: \$1,540,000) at the time of refinance closing in Spring/Summer 2017. The proposal to pay off 13% may change as the investment benefits are revealed. Staff will return to Council to bring forward the loan amendments to the original loan terms, and related documents with the new partnership if a change occurs.

Background: Village Avante Apartments Affordable Housing Project ("Village Avante"), located at 16480 Del Monte Avenue, has been providing affordable housing for families in the community since 1970. Village Avante provides 112 homes for families in 29 buildings on approximately 8 acres, consisting of two to five-bedroom units. Amenities include a basketball court, a playground, and a community building. In 1999, Ecumenical Association of Housing, Inc. ("EAH") purchased Village Avante from its previous owner and performed a minor rehabilitation. Due to the age of the property and to ensure a stable and affordable housing community, EAH proposes to perform the following rehabilitation scope of work for necessary upgrades: replace all building plumbing systems, water heaters, furnaces, windows, doors, sidings, kitchen and bathroom fixtures and appliances, lighting in all rooms, flooring, strengthen weakened structures where necessary, provide two mobility accessible units (ADA units), install solar PV and solar thermal systems, add air conditioning systems, and increase safety and security measures in collaboration with the Police Department (the "Rehabilitation Project").

To finance the Rehabilitation Project, EAH is currently preparing applications to the California Tax Credit Allocation Committee ("TCAC") for federal and state Low Income Housing Tax Credits ("LIHTC") and the California Debt Limit Allocation Committee ("CDLAC") for tax-exempt bond issuance authorization.

EAH requested that the California Municipal Finance Authority ("CMFA"), a joint exercise of powers authority and public entity of the State of California, serve as the municipal issuer of the tax-exempt revenue bonds in an aggregate principal amount not to exceed \$26,000,000. The proceeds of the bonds will be used to: (1) finance the acquisition of Village Avante and the Rehabilitation Project, and (2) pay certain expenses incurred in connection with the issuance of the bonds. Village Avante is to be owned and operated by a limited partnership or limited liability company to be formed by EAH or a related entity, and is to be occupied, in part or in whole, by persons or families of extremely low, low, or very low income.

In order for all or a portion of the bonds to qualify as tax-exempt bonds, a c a public hearing (the "TEFRA Hearing") must be conducted providing for the members of the community an opportunity to speak in favor of or against the use of tax-exempt bonds for the financing of the Rehabilitation Project. In this case, the City Council can provide the opportunity for the public hearing to occur. Following the close of the TEFRA Hearing, an "applicable elected representative" of the governmental unit hosting Village Avante (in this case, the City) must provide its approval of the issuance of the bonds for the financing of the Rehabilitation Project. The EAH development entity is responsible for the full repayment obligation of the bonds. The City does not credit enhance or have any obligation towards the debt obligation. The Rehabilitation Project meets the Council's ongoing priorities of "Supporting Our Youth, Seniors, and Entire Community" and "Maintaining Fiscal Responsibility," particularly the strategy of leveraging outside financing for the purposes of preserving the City's affordable housing supply.

In order to maximize the amount of tax credits the Rehabilitation Project is eligible to receive, Village Avante will need to be acquired by a new ownership entity which will be an EAH-controlled entity, and the new project name will be Park Place. In addition to tax credit equity and a new senior debt from bond issuance, this combined acquisition and Rehabilitation Project will need to be financed with a Seller Take-Back Loan from the current EAH-controlled owner, as well as assignment and assumption of existing loans from the current owner to the new owner, including two loans from the City. Pending City Council approval, the proposed financing plan to for the Rehabilitation Project will entail:

1. TEFRA Hearing

- A public hearing under the TEFRA on March 1, 2017 in connection with the proposed issuance of revenue bonds by the CMFA, in an amount not to exceed \$26,000,000, to (1) finance the acquisition of Village Avante and the Rehabilitation Project, and (2) pay certain expenses incurred in connection with the issuance of the bonds. Village Avante is to be owned and operated by a limited partnership or limited liability company to be formed by EAH Inc. or a related entity, and is to be occupied, in part or in whole, by persons or families of extremely low, low, or very low income.
- The tax-exempt bond financing is a "conduit" financing in which the City has no exposure for the debt. Rather, EAH, the sponsor, asks the CMFA to issue the bonds upon CDLAC's authorization, and then solicits a lender who purchases all of the bonds in a private sale. CMFA is a public entity that is authorized and experienced in the issuance of such bonds.

- As the nature of the financing vehicle is tax-exempt, the TEFRA requires the local jurisdiction to show support for the transaction. This requirement is fulfilled through the public hearing approving the conduit financing after a public notice is published fourteen days prior.
- 2. Assignment of existing City loans to the new LP owner
 - EAH proposes to pay off up to 13% of the outstanding balance (including principal and accrued interest) of the second position loan from the City (original loan principal: \$1,540,000) at the time of refinance closing. (Note: staff may need to return to City Council to provide an update if this proposal changes).
 - To ensure that the City debt maintains its connection with the actual property, EAH requests assignment of the remaining outstanding balance of the second position loan and the entire outstanding balance of the fourth position loan to the new owner mentioned previously.
- 3. Capitalization of accrued interest on existing City loans
 - This not only ensures the interest due on City debt is carried forward to the new ownership, but more importantly, it also provides the City with additional principal from which interest is to be calculated.
- 4. Subordination of existing City loans to a new senior loan
 - This is the same as the financing structure currently on the Project, except a new senior mortgage will be in place. Any senior lender EAH seeks to purchase the tax exempt bonds will request the subordination of all other debt, including the City loans.
- 5. Extension of existing City loans terms to equal the duration of the TCAC Regulatory Agreement in connection with LIHTC (55 years)
 - As a requirement to receiving a reservation of LIHTCs, TCAC requires the property owner to restrict the rents on the units to households at 60% of Area Median Income ("AMI") or below. The term of that restriction is 55 years.
- 6. Amendment of the interest rates on the City loans to equal the annually compounded long-term Applicable Federal Rate ("AFR") at refinancing closing
 - The AFR is a compounding rate that the IRS establishes every month as a floor to interest rate on any loan that does not wish to be considered a taxable event.
 - Currently (February 2017), the annually compounded long-term AFR is at 2.81%, which equals a 5.7% simple interest rate over 55 years, the proposed term of the two City loans. This rate is higher than the 4% simple annual interest rate currently on the City loans.
 - EAH cannot guarantee or anticipate the long-term AFR in the month of refinancing closing; however, to ensure the City loans will not be considered a taxable event by IRS, thus avoiding unnecessary tax expenditure, EAH requests the interest rates on the City loans to be fixed at the annually compounded long-term AFR in the month of refinancing closing, anticipated to close in Spring 2017.

CALIFORNIA MUNICIPAL FINANCE AUTHORITY:

The CMFA was created on January 1, 2004 pursuant to a joint exercise of powers agreement to promote economic, cultural and community development, through the financing of economic development and charitable activities throughout California. To date, over 220 municipalities have become members of CMFA.

The CMFA was formed to assist local governments, non-profit organizations and businesses with the issuance of taxable and tax-exempt bonds aimed at improving the standard of living in California. The CMFA's representatives and its Board of Directors have considerable experience in bond financings. The City is a member of the CMFA's JPA.

The bonds to be issued by the CMFA for the Rehabilitation Project will be the sole responsibility of the Borrower, and the City will have no financial, legal, moral obligation, liability, or responsibility for the Rehabilitation Project or the repayment of the bonds for the financing of the Rehabilitation Project. All financing documents with respect to the issuance of the bonds will contain clear disclaimers that the bonds are not obligations of the City or the State, but are to be paid for solely from funds provided by the Borrower.

There are no costs associated with membership in the CMFA and the City will in no way become exposed to any financial liability by reason of its membership in the CMFA. In addition, participation by the City in the CMFA does not impact the City's appropriations limits and does not constitute any type of indebtedness by the City. Outside of holding the TEFRA Hearing and adopting the required resolution, no other participation or activity of the City or the City Council with respect to the issuance of the bonds will be required.

COMMUNITY ENGAGEMENT: Inform

The community was informed by notices published in the San Jose Mercury News and the Morgan Hill Times on February 3 (see attached).

ALTERNATIVE ACTIONS:

As an alternative to the staff recommendation, the City Council may decide to not adopt the resolution approving the issuance of bonds by CMFA.

PRIOR CITY COUNCIL AND COMMISSION ACTIONS:

The City Council approved entering into loan agreements with EAH for Village Avante in the amount of \$1,540,000 on June 1, 1999, and \$640,000 on November 6, 2000. In addition, the Council previously received this report, adopted a resolution, and held a TEFRA hearing on January 20, 2016 on this item.

FISCAL AND RESOURCE IMPACT:

This action has no fiscal impact on City funds. The City is holding a TEFRA Hearing needed for approval of issuance of bonds by CMFA, not issuing bonds themselves. The Board of Directors of the California Foundation for Stronger Communities, a California non-profit public benefit corporation (the "Foundation"), acts as the Board of Directors for the CMFA. Through its conduit issuance activities, the CMFA shares a portion of the issuance fees it receives with its member communities and donates a portion of these issuance fees to the Foundation for the support of local charities. With respect to the City, it is expected that that a portion of the issuance fee attributable to the City will be granted by the CMFA to the general fund of the City at a later time. Such grant may be used for any lawful purpose of the City. The Borrower will be the beneficiary of the CMFA's charitable donation through a

25% reduction in issuance fees.

As part of this transaction, the loans from the City to EAH will be modified as follows: interest will be capitalized (added to the principal), the loans will be subordinate to the new senior loan, the term of the loans will be extended to a duration of 55 years, and the interest rate will be based on the AFR.

CEQA (California Environmental Quality Act):

Not a Project

The proposed action (TEFRA Hearing) is not subject to the California Environmental Quality Act (CEQA) as defined in Section 21065 of CEQA and Section 15378 (b)(4) of the State CEQA Guidelines and, as such, no environmental document pursuant to CEQA is required.

This CEQA clearance is limited to the actions described above related to the Rehabilitation Project's financing. A project level CEQA analysis shall be required prior to issuance of any project development approval.

LINKS/ATTACHMENTS:

1. Resolution
2. Morgan Hill Times Notice
3. San Jose Mercury News Notice