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NOV 20 2009

Memorandum by City Manager's Office

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Debra Figone

SUBJECT: Transmittal of Memo Responding
to RDA Budget Document #11

DATE: November 20, 2009

INFORMATION

Attached is a memorandum from Housing Director Leslye Krutko which 1) responds to questions posed by Councilmember Pyle and Councilmember Liccardo in RDA budget document #11 as well as 2) provides an overview of the efforts to date to evaluate options for paying for all or some of the RDA state take of \$75 million by borrowing from 20% housing funds. I would like to convey to the Mayor and City Council the following key points:

- 1) The Housing Director and other members of the City Administration have been working diligently for quite some time with Agency staff to fully evaluate all options for borrowing Housing funds.
- 2) Although a full range of options from limited to maximum borrowing have been explored, the RDA and City staff have tried to develop borrowing scenarios which maintain some housing programs. The guiding principles referenced in the memorandum have been our administrative guide but do not dictate council policy decisions.
- 3) The extensive research and work to date has been with the assistance of the Housing and RDA financial advisor and has included discussions with some of the banks with whom the City has existing relationships. A snapshot of work and findings to date is provided. Information continues to evolve, including the impact of the legal analysis of the legislation which allows for housing borrowing. The final answer on any Council direction to borrow will be determined once the City formally accesses the credit markets. Only then will all required information regarding terms and impacts be known.
- 4) As I have stated repeatedly, these are challenging times. The Mayor and City Council have difficult policy decisions to make in resolving fiscal issues confronting both the City and RDA. The Administration will continue to work to ensure that the Mayor and City Council have the best information and policy advice we can provide in order to assist you to make informed decisions. My staff and I will continue to work collaboratively with the RDA to assist where needed.

Debra Figone
City Manager



NOV 20 2009


Memorandum by City Manager's Office

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: November 20, 2009

Approved  Date *11/20/09*

INFORMATION

SUBJECT: AGENCY PROPOSED BUDGET—QUESTIONS REGARDING THE IMPACT OF THE BUDGET PROPOSAL ON THE CITY'S AFFORDABLE HOUSING PROGRAM

This Memorandum responds to questions posed by the Mayor and City Council, including those detailed in Councilmember Liccardo and Pyle's November 12th memorandum, regarding the proposal to use the City's Affordable Housing funds to pay for the \$75 million State SERAF obligation. Per State legislation, the Agency must make a \$62 million payment to the State by May 2010 and a \$12.8 million payment by May 2011. The legislation allows for several options for making the SERAF payment, including using any legally available 80% funds, borrowing or suspending payment to the 20% Housing Fund, using any other available revenue sources.

The proposed Agency budget envisions two payments from the Housing Department to pay the State—a \$40 million payment in the current fiscal year, and a \$35 million payment in Fiscal Year 2010-11. As required by State law, any funds borrowed from the Affordable Housing Fund ("Housing Fund") must be repaid within five years. Therefore, the first year proposed borrowing of \$40 million in FY 09-10 must be paid back by June 30, 2015 and the proposed second year borrowing of \$35 million in FY 10-11 must be paid back by June 30, 2016. Should the funds not be paid back by these dates, the Low and Moderate Income Housing Fund will increase from the current 20% level to a 25% Fund.

It should be noted that an outstanding issue remains regarding how much the Agency can borrow more from the Housing Fund in the second year than the amount due to the State for the second year SERAF payment. The Agency proposes to borrow \$35 million from the Housing Fund in Year 2 when the amount of the actual payment due from the Agency to the State is only \$12.8 million. This issue would need to be resolved if the City Council were to take an action in Year 2 to borrow these funds from the Affordable Housing Fund.

Current Situation

Because of the nature of affordable housing construction, Housing Department (“the Department”) funds are committed early in the life of the development and are typically drawn down over time as projects progress through construction (construction draws). As a result, the borrowing strategy for the Department in the past has been to draw on a line of credit, which is then taken out by a long-term bond issuance once the line of credit has been expended or committed to housing projects. This strategy has worked well for the affordable housing program as it achieved flexibility and efficiency by ensuring that funds are available when needed, and at lower short term borrowing costs. Once the line of credit was fully utilized, the long term bonds were issued; the line of credit was repaid and subsequently replenished for future use of new projects. This strategy has enabled the Department to issue long-term bonds only when needed and, in so doing, it has preserved future bonding capacity.

In October 2008, the Department’s existing line of credit provider, the Bank of New York, chose to exit the municipal finance industry, including providing letters of credit and lines of credit. This decision affected the Department in two respects as Bank of New York also provides a letter of credit to secure approximately \$56.7 million of variable rate demand bonds – that letter of credit expires in June 2010.

As a result of Bank of New York’s pronouncement, the Department drew on the full line of credit, which then converted to a five-year term, low interest rate loan with \$2.5 million quarterly principal payments (\$10 million per year for 5 years). This payment now adds to the approximate \$20 million in annual debt payments the Department makes on outstanding tax allocation bonds. The Department now spends \$30 million of its \$40 million (75%) in tax increment to cover annual debt service payments

In April 2009, after the financial markets began to show signs of settling down, the Department assembled a financing team, comprised of staff from the Department, the Finance Department, the Redevelopment Agency, the City Attorney’s Office, and financial advisors, to obtain a replacement line of credit for the City’s affordable housing program. The team canvassed the universe of banks that provide credit facilities – a universe that had contracted significantly in the past few years in light of systemic financial meltdown. The only bank that was willing to engage in a conversation with respect to a replacement line of credit was Wells Fargo, who recently had become the City’s depository bank. The other banks were not interested either because of their concern with redevelopment credit in general statewide and/or because they did not have an existing business relationship with the City. In the current banking market, banks typically will need to have both comfort with the credit and the opportunity to provide other banking services. However, after much analysis, Wells Fargo was not willing to provide a replacement line of credit because it would need to be paid *after* the debt service on the Department’s existing obligations (including the Bank of New York term loan). As a result, and because all other available affordable housing cash has been committed to projects, the Department has not made new funding commitments since last Spring. As a result of the existing credit situation and its careful approach to issuing bonds in the past, the Department has borrowing capacity available.

Affordable Housing Pipeline

Attachment A details the affordable housing projects in the development pipeline that have been awaiting funds once the Department is able to secure a new line of credit. This chart details the amount of City funds requested, the amount of funds already spent by the developer on predevelopment activities, and the amount needed to purchase the site. Additionally, information on economic development and readiness is provided to show the estimated number of jobs that will be created, the amount of revenue the City will collect as a result, and how soon the development could begin construction.

Mechanics of Borrowing/Guiding Principles

In order to provide the City Council with the opportunity to make a policy decision regarding the loan of Affordable Housing funds to pay all or a portion of the SERAF payment, the financing team has been working on a strategy that could provide the needed funds. The Department has worked closely with internal partners and with its financial advisor to develop a successful borrowing strategy.

In structuring a potential borrowing, the Housing Department and Redevelopment Agency jointly agreed on basic guiding principles including:

1. Department would model a loan of \$40 million in Year 1 and a loan of \$35 million in Year 2 to the Agency to fund SERAF to mirror the Agency's proposed revised budget.
2. The Department's core programs of Housing Rehabilitation (emergency repairs, health and safety repairs), Mobilehome Rehabilitation, and the Teacher Homebuyer Program remain funded.
3. All current commitments as evidenced by City Council approval be honored (see Attachment B-- List of Current Project Commitments)
4. The Markham Terrace project, which must be rebuilt due to HUD financing requirements, would be funded.

The strategy to accomplish both the goal of providing funding for the Agency to make the SERAF payment in accordance with the stated guiding principles would involve two separate borrowings. The costs to issue the bonds attributed to the SERAF payment for the five year period from issuance until the loan is repaid is estimated at \$28 million (exclusive of the costs associated with refinancing the line of credit loan).

1. **Year 1 (FY 2009-10)** -- The Department would issue \$50 million taxable variable rate bonds backed by a letter of credit bank. This approach would net approximately \$45 million after issuance costs and reserves, and at the same time refinance the Department's \$56.7 million in tax-exempt variable rate bonds to fixed-rate bonds. The \$50 million is the amount of variable rate debt believed to be financially feasible and prudent for the Housing program and is consistent with the amount the Wells Fargo had been considering in connection with the line of credit deliberations. The benefits of this borrowing approach are multi-fold:

- a. Flexible financing - unlike fixed rate debt, these bonds could be repaid at any time should the California Redevelopment Association (CRA) lawsuit challenging the SERAF payment be successful. If the lawsuit is successful, the bonds then could be repaid by the Agency's repayment of SERAF loan.
 - b. Low Cost Financing – This strategy takes advantage of lower variable rate interest rates; projected at 4.5% versus a range of 7.5% to 8.0% for fixed rate debt. In the current market, the variable interest rate is approximately 0.30% plus letter of credit fees.
 - c. Mitigates uncertainty and Benefits from ARRA - Refunds the Department's existing variable rate bonds with fixed rate bonds which have a letter of credit with Bank of New York expiring on June 2010. Benefits from a provision in the federal stimulus package that enables qualifying bonds to be issued on a fully tax-exempt basis rather than tax-exempt bonds subject to AMT (alternative minimum tax), thereby saving on interest costs. The bonds being refinanced from variable to fixed rate are the bonds eligible for the provision in the federal stimulus package.
 - d. Work Underway -- A financing team has already been working on this option.
1. **Year 2 (FY 2010 – 11)** -- The Department would seek to issue an estimated \$75 - 80 million in taxable bonds, which would net \$68 - 72 million. The proceeds would be used to repay the outstanding balance on the Department's existing line of credit loan with Bank of New York and provide funds for the proposed \$35 million loan to the Agency for the SERAF payment.

The financing team considered several other options, including borrowing the full amount of the SERAF payment in Year 1. This option was not pursued, however, because it did not meet the guiding principles noted above and did not provide the benefits of the Year 1 variable rate borrowing. As detailed by the Department's financial advisor, the reasons why this is not practical or recommended include:

1. If the Department were to attempt a borrowing for the full \$75 million in the first year, it would be necessary to borrow in excess of \$125 million. A borrowing of this size would be required because the Department would need to repay its line of credit loan in order to have sufficient cash to cover the new debt service payment.
2. The borrowing would need to be completed on a fully taxable basis; a much more expensive strategy (an estimated 8%+ annually).
3. Bonds would not be able to be repaid should the CRA lawsuit be successful and given the size of the financing it would be difficult for the Department to spend these funds in an expedited manner, since funds are needed for construction draws over time. This increases the costs to the Department, as debt service must be paid on funds that are not drawn down.
4. Insufficient funds would be available to pay for the core Department programs listed above, or to pay for the development of the Markham Terrace project.
5. Department would be highly leveraged, which could potentially result in a rating downgrade and ultimately higher borrowing costs.

6. Untested strategy with potential bond buyers and it is unknown as to whether there would be sufficient interest from potential investors. A recent survey of taxable bond deals completed in 2009 shows that four California communities successfully issued fixed rate taxable tax allocation bonds this year. The particulars of these four deals included; largest issue was \$75 million; longest maturity was 15 years; and the debt coverage ratios ranged from a low of 1.31x to a high of 3.78x. In this borrowing scenario, the Housing Department's bond issue would be larger, with a much longer maturity (30 years); and at a lower debt coverage ratio.

The financing team also looked at two other possible options:

1. A Two-Year Strategy If the Variable Rate Proposal Was Infeasible— This strategy would include the issuance of two fixed rate taxable bond issues, one in the current fiscal year that would net \$40 million and one next fiscal year that would net \$31 million.
2. Borrowing \$62 million in Year 1 and \$13 million in Year 2— With the increased size of the Year 1 borrowing (from \$40 million to \$62 million), it would be necessary to repay the line of credit loan in Year 1.

These options were not pursued because they proved to have the same shortfalls as the one-year borrowing strategy detailed above.

Financial Market Interest

To date, the financing team has not been able to find a bank willing to provide a letter of credit for a \$50 million variable rate taxable bond issue if the bond proceeds were to be used to make SERAF payments. Wells Fargo Bank initially declined to participate if the funds were used to pay the State, but left the door open if the City instead wanted to borrow to fund affordable housing projects. Bank of America (BofA) declined to participate for either the SERAF or affordable housing purposes, citing concerns about the economy and the potential for a reduction in tax increment revenues.

The City has not approached other banks to provide a letter of credit, largely because BofA and Wells Fargo have established working relationships with the City and are familiar with the credit, discussions have been underway for nearly a year, and both banks have been disinterested in providing the letter of credit to date. As noted earlier, other banks are reluctant to extend credit for redevelopment agencies and in reality are not providing letter of credits to organizations where a prior business relationship does not exist.

The financing team has continued to discuss options with the Wells Fargo and BofA and address concerns they have raised. The most promising alternative under discussion with Wells Fargo Bank is a scenario where the City would proceed with issuing the \$50 million in variable rate taxable bonds and refinance the existing variable rate bonds as taxable bonds, using the proceeds to fund affordable housing projects. The cash that is now committed to those projects could be freed up and made available to make the SERAF payment. Wells Fargo Bank is evaluating this

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option, and current conversations have been cautiously optimistic. Wells Fargo has indicated, however, that they will need to have a complete understanding of what projects would be funded and how the Agency planned to address the State take prior to making any decision in order to ensure that bond proceeds were being used for housing projects. It also indicated that it may include a prohibition against the use of bond proceeds to fund SERAF directly. BofA is also reconsidering its initial decision and is considering additional security (e.g., loan repayments) to provide a higher comfort level for the bank. We expect to get additional feedback from both banks in the next couple of weeks.

It should be noted that the Agency anticipates issuing \$30 million in bonds in the same timeframe as the proposed Housing Department borrowing. We will need to be cautious in how we coordinate the disclosures for the two borrowings and timing of the bond issues as to not to compete for the same set of investors and potentially confuse the market.

With respect to a Year 2 borrowing, no conversations have taken place with potential investors or credit providers. It is premature to do so although disclosure of future borrowing plans will need to be made in the offering documents and rating agencies for the Year 1 borrowing. The ability to borrow in the future in the projected amounts will be dependent on a number of factors: tax increment revenues, interest rates, and the investor's comfort with the debt coverage ratio (essentially how leveraged will the Department be) and the amount of projected loan repayments that help defray the Department's costs of administering its programs. If the Department were to borrow/finance the full \$35 million as presented in the Agency's proposed budget, assuming no change in increment or market conditions, it would be highly leveraged. A highly leveraged position could lead to a potential reduction in the rating on Housing Tax Increment bonds, currently rated at A2/A/A, resulting in higher interest rates and a smaller investor base.

Impact on the Housing Program

If the City Council approves the two-year borrowing strategy presented by the Housing Department as outlined above, the Department would continue to administer its rehabilitation and first-time homebuyer programs as well as its grant programs and other important efforts (including foreclosure assistance and homeless prevention) assuming no change in tax increment. Additionally, the Department would continue to monitor its \$600 million loan portfolio with 1,600 loans outstanding.

The two-year borrowing strategy would have a direct impact on the Housing Program's new construction program. New affordable housing construction projects require considerable subsidy. If the Agency were to borrow funds from the affordable housing program over the next two years, funds would not be available to make new commitments for affordable housing projects in the pipeline (as described above) and for the next five years (assuming the Agency's tax increment projections.) The Department estimates that approximately 1,000 affordable units would be delayed or lost due to the lack of funding.

Please see Attachment C, which outlines the Housing Department budget for the six-year period that includes the current fiscal year. This attachment includes tax increment funds as well as

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other State and federal funds administered by the Department. Note that it is hard to predict funding in the out years, as much of the Department's funding is as a result of competitive funding applications and will be dependent upon monies available at the State level. (Much of the bond funding approved by Proposition 1C has been committed, so opportunities may depend on the State's effort to create a permanent source of funding for housing). We would expect that the Department would continue to be successful in obtaining additional funding for homeless programs, and for our rehabilitation and homebuyer efforts. There is not, however, other funding available to replace the monies for new construction efforts.

This is a very difficult time, with difficult choices that need to be made. The Housing Department has worked together with the financing team to seek funds that could be used to make the State payment. Clearly, the hope is that CRA wins its lawsuit and that it will be unnecessary to make the SERAF payment to the State. However, in the meantime, the funds must be set aside.

It is important for the Council to understand the implications of addressing the entire State take with the City's affordable housing funds. This memorandum is intended to provide the Council with the information necessary to make an informed policy decision in this regard.

Coordination

This memorandum was coordinated with the Finance Department, the Office of the City Attorney, and the Housing Department's financial advisor.


LESLEYE KRUTKO
Director of Housing

For questions, please contact Leslye Krutko, Director of Housing, at 535-3851

Attachment A—Projects in the Housing Department’s Development Pipeline

Financial Information						
	Total # of Units	City Funds Spent	Funds Requested	Developer Predev Money Spent	Land Purchased	Amt Needed to Purchase Land
2 nd Street Studios – First Comm. Housing	134		13,235,000	1,165,181	no	4,100,000
Leigh Avenue – First Comm. Housing	64		6,335,000	691,404	no	2,660,700
Rosemary Seniors – ROEM	106	3,700,000	11,910,000	500,000	yes	N/A
Rosemary Family – ROEM	184	6,300,000	6,840,000	500,000	yes	N/A
Donner Lofts – Affirmed	156		12,233,384	700,000	no	3,995,000
Ford and Monterey – Eden Housing	95	7,000,000	6,500,000	350,000	yes	N/A
Japantown Seniors – First Comm. Housing	75		7,410,000	300,202	no	2,175,000
Willow Glen Woods – Satellite Housing	77	3,545,000	4,750,000	100,000	yes	N/A
Blossom Hill – Charities Develop.	152		22,365,000	350,000	no	8,250,000
2500 Senter – Charities Develop.	122		13,460,000	350,000	no	5,160,000
Park & Delmas – Midpeninsula Hsg.	85		8,500,000	25,000	no	4,000,000
Edenvale – Midpeninsula Hsg.	110		8,800,000	25,000	no	Donation
163 Baypointe – EAH	184	100,000	23,641,557	0	no	12,000,000
TOTALS	1,544	\$20,645,000	\$145,978,941	\$5,056,787		\$42,340,700

	Economic Development and Readiness			Start of Construction				
	Est. Construction Jobs	Est. Permanent Jobs	Est. City Fees and Taxes	Zoning	PD Permit	6-12 mo	12-24 mo	24-36 mo
2 nd Street Studios – First Comm. Housing	125	38	729,630	Y	Y	X		
Leigh Avenue – First Comm. Housing	60	18	348,480	Y	Y	X		
Rosemary Seniors – ROEM	99	30	577,170	Y	Y	X		
Rosemary Family – ROEM	278	70	1,001,880	Y	Y	X		
Donner Lofts – Affirmed	145	44	849,420	Y	Y	X		
Ford and Monterey – Eden Housing	134	36	517,275	Y			X	
Japantown Seniors – First Comm. Housing	70	21	408,375			X		
Willow Glen Woods – Satellite Housing	116	29	419,265				X	
Blossom Hill – Charities Develop.	141	43	827,640					X
2500 Senter – Charities Develop.	184	46	664,290					X
Park & Delmas – Midpeninsula Hsg.	128	32	462,825					X
Edenvale – Midpeninsula Hsg.	166	42	598,950					X
163 Baypointe – EAH	278	70	1,001,880	Y			X	
TOTALS	1,924	519	\$8,407,080					

**Attachment B-- Affordable Units - Estimated Completion Based on Housing
Department Making \$75 million Payment (\$40 million in Year 1, \$35 million in Year 2)**

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	TOTAL
Fairways at San Antonio (completed 8/09)	86						
Hillsdale Townhouses (est. completion 11/09)	48						
Corde Terra Seniors (est. completion 12/09)	201						
The Commons (Bill Wilson)		28					
Roundtable Drive Four-plexes		8					
Brookwood Family			84				
North 4th Street			100				
Cornerstone at Japantown			53				
Orvieto Family			92				
Belovida Seniors			180				
McCreery Courtyards				79			
90 Archer St.				42			
Markham Terrace				102			
Kings Crossing				92			
Family Shelter				35			
Total Number of Units Completed	335	36	509	350	0	0	1230

**Attachment C—Housing Department Budget with SERAF
Take of \$40 Million in Year 1 and \$35 Million in Year 2**

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	TOTAL
New Construction	\$64,759,868	\$15,563,801	\$9,085,000	\$8,750,000	\$8,259,353	\$10,759,353	\$117,177,375
Rehabilitation	\$7,428,300	\$5,500,000	\$4,500,000	\$4,500,000	\$4,500,000	\$4,500,000	\$30,928,300
First Time Homebuyers	\$20,965,000	\$10,500,000	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000	\$47,465,000
Homeless Programs	\$6,677,600	\$4,606,600	\$1,242,600	\$1,242,600	\$1,242,600	\$1,242,600	\$16,254,600
Grant Programs	\$6,181,800	\$2,203,000	\$796,000	\$796,000	\$796,000	\$796,000	\$11,568,800
TOTAL	\$106,012,568	\$38,373,401	\$19,623,600	\$19,288,600	\$18,797,953	\$21,297,953	\$223,394,075