

REPORT FROM

OFFICE OF THE CITY ADMINISTRATIVE OFFICER

Date: July 16, 2010

CAO File No. 0220-00540-0907
Council File No. 10-0914-S1
Council District: 13

To: The Mayor
The Council

From: Miguel A. Santana, City Administrative Officer *dit by*

Reference: Los Angeles Housing Department Transmittal dated June 9, 2010; Received by the City Administrative Officer on June 21, 2010

Subject: **AUTHORIZATION TO ISSUE TAX-EXEMPT MULTIFAMILY HOUSING MORTGAGE REVENUE NOTES FOR THE VENDOME PALMS APARTMENTS PROJECT**

SUMMARY

The Los Angeles Housing Department (LAHD) requests authority to issue one or more tax-exempt multi-family housing revenue notes (Notes) in the amount of \$6.3 million to finance the development of the Vendome Palms Apartments Project (Project) located at 975 N. Vendome Street (Project Site) in Council District 13. Authority is also requested to adopt a Resolution, attached to the LAHD transmittal dated June 9, 2010 (Transmittal), and to approve related Note issuance documents. The California Debt Limit Allocation Committee (CDLAC) approved the allocation of the Notes and has established August 25, 2010 as the expiration date of this issuance. This project involves the acquisition and rehabilitation of a vacant two-story building. Upon completion, the Project will provide 35 units of affordable housing for chronically homeless and mentally ill individuals. The Borrower, Owner and Project Sponsor is Vendome Palms, L.P., a California Limited Partnership. This transaction involves Citibank N.A. (Bank) as the construction and permanent lender. It should be noted that this proposed transaction is the second of its kind in the City. The first was approved by Council on June 25, 2010, with Mayor concurrence on June 28, 2010, to benefit the Toberman Village Project (C.F. 10-0914). Specific information relative to the terms of this proposal is provided below and in the Findings Section of this report.

Based on this Office's analysis, we did not identify any specific issues regarding the proposed financing of this Project, despite the unique nature of the transaction. However, the decision to proceed with this proposal is a policy decision because the Bank is named in a pending lawsuit that was filed by the City.

Overview of Proposed Transaction

As proposed, the City will issue one or more Notes totaling up to \$6.3 million. In a traditional bond transaction, the City would issue bonds. The Bank would purchase the bonds, and the sale proceeds would be made available to the Borrower. The Notes will be purchased by the Bank. The purchase proceeds of the Notes will be paid to the City (Funding Loan) which will then lend \$6.3 million to the Borrower (Borrower Loan Agreement). The obligation of the Borrower to the City

(as secured by the Project Site property) will be pledged by the City to the Bank as the sole security for payment of the Funding Loan. The Notes will be purchased by the Bank and will be deposited with a third-party fiscal agent (U.S. Bank National Association) and will be loaned to the Borrower. In a traditional bond transaction, these duties would be performed by a Trustee. Similar to a bond transaction, the City's involvement is considered true conduit financing because the obligation for repayment is the Borrower's responsibility. The Funding Loan achieves tax-exempt status through the receipt of a tax-exempt allocation from CDLAC. In proposing this alternative financing structure, the Bank has agreed to comply with all LAHD Bond Policies and Procedures.

According to the LAHD Bond Team (identified in page six of the Transmittal), this transaction is not considered substantively different from the City's traditional bank private placement bond issuances. Neither the City's Bond Counsel (Kutak Rock) or the Financial Advisor (CSG Advisors, Inc.) identified any drawback or issues that would result in material changes in the obligation of Notes (or bonds) holder, provided that the Funding Loan Agreement and related document clearly identifies that the Funding Loan is a limited obligation of the City, solely repayable from receipts and security receivable under the Borrower Loan Agreement (between the City and the Borrower). These provisions are all included in the proposed Note documents.

Pending Litigation

On June 18, 2010, the Council directed this Office to remove from our qualified list of underwriters those companies that are associated with a current lawsuit with the City (Case No. BC394944) (C.F. 10-0600-S26). It should be noted that the Bank is named in this lawsuit. In July 2008, the City filed two lawsuits in the Los Angeles Superior Court against municipal bond insurers and investment banks, including the Bank. The Council is expected to be briefed on the pending litigation in Closed Session at a later date.

As it is unclear as to what extent the Council wishes to impact any financial transactions involving the Bank, approval of this proposed transaction is a policy decision. If the Council should find that it is beneficial to the City to proceed with the issuance of the Notes as proposed, Recommendation No. One in this report should be adopted. There are significant reasons for supporting this Project, as summarized below:

- The Borrower would not be able to restructure its proposal in time to meet the CDLAC deadline (August 25, 2010), thereby risking the loss of up to \$6.3 million and the loss of 35 new units of affordable housing for chronically homeless and mentally ill individuals if delayed.
- The Borrower, Bank and other involved parties had been negotiating the terms of this Project for many months and the Bank has played a key role in identifying \$11.1 million (\$6.3 million during construction and \$4.8 million for permanent financing). At this time, the Bank is the only financial institution known to have negotiated certain arrangements with the State to facilitate these financings. Additional information concerning this gap financing is discussed in Items No. 4 and 5 in the Findings Section of this report.
- The City will bear no financial responsibility for the repayment of the Notes and there are no City funds being used to issue the Notes.

Given that this proposed transaction is the second to be approved in the City, and in an effort to provide the Council with an opportunity to evaluate the Project progress and to make policy recommendations that may be deemed to be necessary, Recommendation No. One also includes recommendations for the Department to report back in two years, or sooner, upon completion of the Project's construction but prior to the execution of the permanent financing agreements, with an informational status report. This status report would include information relative to the progress of the project, identify all financing sources (if any have changed) and include information relative to the marketing plan, project timeline, anticipated rental rates and plan for moving tenants into the Project Site.

The Borrower will indemnify and hold harmless the City against all loss, costs, damages, expenses, suits, judgments, actions and liabilities of whatever nature directly or indirectly resulting from the design, construction, installation, operation, use, occupancy, maintenance, financing or ownership of the Project. Also, the City's Debt Management Policy is not applicable to this request, as there are no City funds being used to issue the Notes.

RECOMMENDATIONS

It is a policy decision to approve the issuance of up to an amount not to exceed \$6.3 million in a tax-exempt multi-family housing revenue notes for the Vendome Palms Apartments Project, which involves entering into a Funding Loan Agreement with Citibank, N.A. who is named in a pending City lawsuit (Case No. BC394944). We have provided two options for Council consideration.

1. If the Council finds that it is beneficial to the City to issue up to \$6.3 million in tax-exempt multi-family housing revenue notes for the Vendome Palms Apartments Project to provide 35 units of affordable housing for chronically homeless and mentally ill individuals, which involves entering into a Funding Loan Agreement with Citibank, N.A., then approval should be made as follows:

That the City Council, subject to approval of the Mayor:

- a) Adopt the Resolution attached to the Los Angeles Housing Department (LAHD) transmittal dated June 9, 2010 (C.F. 10-0914-S1), authorizing the issuance of up to \$6.3 million in tax-exempt Multifamily Housing Revenue Notes – Series 2010B (Notes) for the Vendome Palms Apartments Project (Project) located at 975 N. Vendome Street, Los Angeles CA 90026 in the Thirteenth Council District;
- b) Approve the related construction loan documents on this matter in substantial conformance with the draft documents as provided in C.F. 10-0914-S1, subject to the approval of the City Attorney as to form; and,
- c) Authorize the General Manager, LAHD, or designee, to:
 - i. Negotiate and execute the construction loan documents, subject to the approval of the City Attorney as to form; and,

- ii. Report back to the Council within two years or sooner, upon completion of the Project's construction but prior to the execution of the permanent financing agreements, with a status report to include the following information: progress of the project, identify all financing sources (if any have changed), additional revenues to be generated, information relative to the marketing plan, project timeline, anticipated rental rates and plan for moving tenants into the Project Site.
2. If the Council finds that it is not beneficial to the City to issue up to \$6.3 million in tax-exempt multi-family housing revenue notes for the Vendome Palms Apartments Project, which involves entering into a Funding Loan Agreement with Citibank, N.A., then the Council should Receive and File this item.

FISCAL IMPACT STATEMENT

There is no impact to the General Fund. If Recommendation One is adopted, funding authority for the tax-exempt Multifamily Housing Revenue Notes (Notes) will be provided from the California Debt Limit Allocation Committee. No City funds would be requested at this time. The Borrower will pay all costs associated with the issuance of the Notes. Approval of Recommendation One will also enable the developer of the Vendome Palms Apartments Project to secure funding from the Notes to provide 35 units of affordable housing for chronically homeless and mentally ill individuals. The City's Debt Management Policy is not applicable as there are no City funds being used to issue the Notes.

FINDINGS

1. Basis for Report

The Los Angeles Housing Department (LAHD) submitted a transmittal dated June 9, 2010 (Transmittal) relative to the issuance of one or more tax-exempt multi-family housing revenue notes (Notes) in the amount of up to \$6.3 million to finance the development of the Vendome Palms Apartment (Project) located at 975 N. Vendome Street (Project Site) in Council District 13. The City Administrative Officer was instructed to review the requests and to make recommendations on these items.

2. Background

In September 2009, the Project received approval for an allocation of up to \$6.3 million from CDLAC. The Project Sponsor had previously been unsuccessful in proceeding with the project due to the uncertainty of the availability of financing available from the California Department of Housing and Community Development (HCD) through the Multifamily Housing Program (MHP). Upon completion, the Project will include a total of 36 units, including: a) 33 studio units; b) one two-bedroom unit set aside for on-site management; and, c) two one-bedroom units. The household Area Median Income percentages will be at or below 50 percent, as established by the U.S. Department of Housing and Urban Development. These tenant affordability restrictions are identified on page three of the Transmittal.

The Regulatory Agreement associated with this project requires that the affordability restrictions remain in effect for 55 years. The 55-year term and other affordability requirements also apply due to the Project's financing assistance from sources such as: Four Percent Low Income Housing Tax Credits (LIHTC); federal Affordable Housing Program (AHP) funds; LAHD's Permanent Supportive Housing Trust Funds (PSHP) from the 2008 - Round Two Notice of Funding Availability (C.F. 07-3466; 07-3466-S1); the Housing Authority County of Los Angeles City of Industry (HACLA-COI) funds and a commitment of MHP funds.

3. Project Budget and Financing

The total development costs (TDC) are estimated to be approximately \$13.5 million and will be financed in two stages: a construction loan and a permanent loan. The Sources and Uses are identified on page six of the Transmittal. The funds will be used to pay for acquisition costs (\$3.7 million), construction costs (\$5.4 million) and other soft costs (\$4.4 million). The Project will utilize a variety of public funding sources during construction including: the Bank loan (up to \$6.3 million, or lower at \$6.2 million); PSHP (\$2.5 million); HACLA-COI (\$2.0 million); and other sources such as tax credits (\$2.7 million). The permanent loan will include the following sources: PSHP (\$2.5 million); LIHTC (\$3.0 million); MHP financing (4.8 million); HACLA-COI (\$2.0 million) and other sources such as AHP funds (\$1.2 million).

The Bank will purchase the tax-exempt Notes in the amount of up to \$6.3 million and make a construction loan to the Borrower. The construction loan will have a term of 24 months and will bear a variable interest rate not to exceed 12 percent. The current estimate for the interest rate is 5.0 percent. The Borrower will repay the construction loan by utilizing permanent sources.

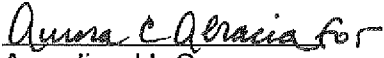
4. Multifamily Housing Program

The \$4.8 million award from MHP (Commitment No. 08-SHMHP-5927) would normally be funded from proceeds from the sale of Proposition 1 (C) bonds. However, due to the State's uncertain bonding capacity and lack of confidence among the lending community to purchase the bonds, HCD could not guarantee that funds would be available upon completion of construction. The LAHD reported that on April 26, 2010, the State Office of the Treasurer (Treasurer) made an offer to the Bank involving the guarantee of funding for 24 MHP-approved multifamily rental housing projects, including this Project. The two parties agreed that, upon completion of the Project, the Treasurer will sell to the Bank tax exempt bonds equal to the amount of the MHP commitment (\$4.8 million). The Treasurer will enter into a bond purchase contract with the Bank to issue and deliver the bonds. The source of repayment for the loan will be Project revenues. At this time, the Bank is the only financial institution known to have negotiated this arrangement with the State. This agreement relieves an otherwise significant funding gap for the Project. The LAHD reports that labor costs for the Project will be subject to the higher of the State of California's Prevailing Wage requirements and/or federal Davis Bacon wages.

The Notes qualify for a federal tax exemption under the Internal Revenue Code of 1986 only if the Notes are approved, following a public hearing in accordance with the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), by the local jurisdiction in which the Project Site is located. On December 30, 2008, LAHD conducted a TEFRA public hearing. LAHD did not receive any written or verbal comments opposing the project. In February 4, 2009, the TEFRA Resolution and Minutes were adopted by Council (C.F. 07-4170-S1).

5. Community Reinvestment Act Requirements

This proposal was prompted, in part, due to efforts by the Bank to gain Community Reinvestment Act (Reinvestment Act) "lending" credits. The Reinvestment Act of the Housing and Community Development Act of 1977 is a federal law established to encourage commercial banks and savings associations to provide financing to borrowers in all communities, including low- and moderate-income neighborhoods through certain qualifying activities. If lenders, such as the Bank, show that they actively serve, invest and/or lend in low-income areas, they receive a better rating. Until recently, the Bank understood that bond issuances were considered "lending" activities. However, bond issuances only qualify as "investment" activities. The proposed Notes issuance qualifies as "lending."


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