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SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

February 27, 1990

Budget and Finance Committee
of the City Council
Sacramento, CA

Honorable Members in Session:

SUBJECT: Proposed Criteria for Evaluation of Multifamily Mortgage Revenue Bond Refundings - City and County of Sacramento

SUMMARY

The attached report is submitted to you for review and recommendation prior to consideration by the City Council of the City of Sacramento.

RECOMMENDATION

The staff recommends approval of the attached resolution approving the criteria.

Respectfully submitted,

Bob Smith

ROBERT E. SMITH
Executive Director

TRANSMITTAL TO COMMITTEE:

Jack Crist

JACK R. CRIST
Deputy City Manager

Attachment

March 6, 1990

City Council of the
City of Sacramento
Sacramento, California

Honorable Members in Session:

SUBJECT: Proposed Criteria for Evaluation of Multifamily Mortgage Revenue Bond Refundings

SUMMARY

This report recommends a set of criteria for Sacramento Housing and Redevelopment Agency (SHRA) staff to use to evaluate whether or not to support current refundings of multifamily projects presently financed with mortgage revenue bond funds, specifically where a condition of economic default may exist.

BACKGROUND

Between 1983 and 1988, the Agency issued twenty-three (23) mortgage revenue bond issues which provided proceeds of $358,372,000 for mortgages for fifty-six (56) multifamily projects. Today, of a total 9,810 rental units in those projects, 2,023 or 20.6% of the units have been set aside for low and moderate income units. The original interest rates on the bond funded mortgages for many of those projects are higher than the conventional mortgage rates that are available today. Thus, owners of those multifamily projects have begun to express to Agency staff their desire to seek lower interest rates through tax-exempt current refunding of the bonds.

Under a current refunding, the old bonds are redeemed and new bonds are issued at a lower interest rate. The new issuance is subject to the original tax law rules that applied to the original bond issuance. Since the tax law has become more stringent since 1985, exemption from new tax law rules is a benefit to the developer. Refundings can be done under two scenarios. The first is at a scheduled prepayment date (called "optional redemption or prepayment") and generally entails the

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payment of a prepayment premium to the bondholders for the inconvenience of having bonds redeemed earlier than promised. The second entails a technical or monetary default that triggers a bond redemption, and makes possible a bond refunding. A technical/monetary default is defined as one not within the developer's control due to events such as high vacancy rates, project damage or lower than projected rents resulting in the project being unable to support its debt and operating default based expenditures. A prepayment premium is not paid.

Recently, the Agency has received inquiries from two owners of multifamily projects funded by City or County Mortgage Revenue Bonds (MRB) requesting that staff consider supporting default based current refundings of the existing bond financing. In both cases, property owners base their requests for refundings on the economic default terms of the bond indentures. To date, staff has been reluctant to support the current refundings that are based on economic defaults because, as a bond issuer, the Agency must protect the interests of the bondholders and the Agency's ability to issue bonds in the future. The penalty to the bondholder(s) of a proposed current refunding based upon a default redemption and refunding is that the bonds are called at par value. The prepayment premium (ordinarily two to three percent of the total value of the bonds that would normally be paid at a refunding) would not be paid. One concern that staff has discussed with the Agency's bond counsel is that property owners could, theoretically, present the appearance of, or manufacture an economic default, when it may or may not exist. The difficulty becomes one of defining what conditions must exist for a default to be legitimate, since each project, each developer and each lender have different levels of tolerance of economic default and different methods by which to handle a project in a position of economic hardship. Bond counsel has advised staff that there is a potential for bondholder litigation if a current refunding is undertaken which improperly uses the default redemption provisions of an issue in reliance upon an artificially created default. Given the lack of standard criteria by which to determine if an economic default does or does not exist, the City is at some risk in agreeing to refund bonds based on economic hardship circumstances.

Thus, a principal purpose of establishing a process and criteria for evaluating proposals for current refundings of bonds based on economic default is for staff to have an objective process in place by which to evaluate refunding requests. It should be noted that the City Council is not obligated to agree to refund the bonds under any circumstance.

The MRB program has made a significant contribution to the total existing supply of affordable rental housing in Sacramento. The Agency's goal is, certainly, to retain those units as affordable by allowing projects to continue under the MRB program through bond refundings or new issues. It is also pertinent that the issuance and annual administrative fees (.25 basis points and .125 basis points, respectively) collected under the MRB program, provides a significant amount of the revenues for operating the SHRA housing development program. Therefore, the MRB program is a very valuable asset to the City and County's affordable housing efforts - it provides a large number of below market rental units and it provides funds for administration and development of other housing resources. In addition, in doing a refunding, the City can request increased regulatory concessions such as a longer term or increased targeting. This provides an additional public benefit in pursing current refundings. Thus, when staff is presented with a proposal to refund bonds to refinance a project in default, staff faces a dilemma - how to protect bondholders while retaining the affordable units and continuing the revenue stream from administrative fees. Consequently, there is a chance that the Agency's objectivity could be influenced by the Agency's interests absent prior adopted evaluation criteria.

This report recommends such an objective process and a set of evaluation criteria. The process is to be a standardized method for evaluating whether the facts, as presented by the proponent, support a condition of economic default with a project, and if the economic default is sufficient grounds for refunding the existing bonds and refinancing the project. Further, where staff is satisfied that a current refunding of bonds is justified, either on the basis of economic default or pursuant to an optional prepayment, staff recommends obtaining regulatory concessions. Examples of this include: extension of the regulatory agreement to the end of the term for the longest bonds or, at minimum, fifteen to twenty years from the date at fifty (50%) percent occupancy of the subject multifamily project; increasing the total percentage of units to be set aside as affordable possibly above the legally required twenty (20%) percent minimum set-aside and/or increasing the percentage of set-aside units targeted for very low income renters. One goal may be to have at least one-third of the total set-aside made available to very low income households. Currently, on some projects, seven (7%) percent of the units must be occupied by very low income households pursuant to a previously adopted local policy. The majority of the projects, however, are only subject to Federal law that requires twenty (20%) percent of the units to be set aside for lower income (under 80% of median) households.

Finally, it should be well noted that the Agency will consider a request for a default based bond refunding only after receipt of the administrative fee (.25% of the bond amount) and a copy of the subject property lender issued and filed Notice of Default. Such action places the project in the foreclosure process. This provides more assurance to the Agency that the project is unquestionably economically distressed. It also places the initial burden of addressing the curing of the default on the property owner and lender. For example, when a property begins to have serious economic difficulties, the property owner must work with the lender to explore all possible remedies to correct the problem, including increasing rents, reducing operating costs and/or providing more capital for the project. Only after other remedies are tried and exhausted and the project continues to have economic problems will the Agency consider refunding current bonds and reissuing bonds for the project.

For the reasons presented herein, it is recommended that the criteria attached as Attachment "A" and questionnaire attached as Attachment "B" be adopted and used by staff to evaluate proposed current refundings that are based on possible economic default.

In summary, where owners of multifamily projects having mortgages funded by Agency-issued bonds request refunding of the bonds, based upon economic default, the process and criteria to be used by Agency staff to determine if the Agency should refund the bonds is as set out in Attachment "A."

FINANCIAL DATA

The Agency receives an annual administrative fee of 12 basis points of the loan amount on each project, to the extent bonds are outstanding. The revenues collected from these fees are used to support SHRA housing programs. In the event a refunding is done, the Agency will receive its traditional 25 basis points up front issuance fee. For example, on a $10 million bond issue, the issuance fee would be $25,000 and the annual fee would be $10,000-$12,000.

ENVIRONMENTAL IMPACT

This is a policy action which is exempt from environmental review per:

CEQA: Section 15378(b)(3)

NEPA: 24 CFR Part 58.34(a)(2)

MBE/WBE

The action proposed in this report has no MBE/WBE impact.

POLICY IMPLICATIONS

The proposed MRB current refunding criteria, if adopted, will establish a policy that all multifamily bond funded projects proposed for current refunding, due to loan default circumstances of bonds, will be subject to a set of standardized and objective evaluation criteria. The policy and evaluation criteria process is designed to reduce or eliminate the Agency's potential risks associated with default based current refundings of bonds. It should be reiterated that the Council is under no obligation to agree to issue refunding bonds for any reason.

In addition, regulatory concessions are recommended under current refundings because developers are obtaining a lower interest rate. The regulatory concessions for a default refunding will have to be carefully assessed, since the project's economic condition may prevent deeper targeting. Examples of regulatory concessions include: longer terms, larger percentage of low/very low income units, and the imposition of rent restrictions where none were previously applied. Attachment "C" outlines the various legal restrictions that have applied to our projects.

SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

VOTE AND RECOMMENDATION OF COMMISSION

At its regular meeting of February 26, 1990, the Sacramento Housing and Redevelopment Commission adopted a motion recommending approval of the attached resolutions. The votes were as follows:

AYES:

NOES:

ABSENT:

RECOMMENDATION

The staff recommends adoption of the attached resolution establishing a process and a set of evaluation criteria to be used for review of proposed current refundings of bonds for multifamily housing projects where a condition of economic default might exist.

Respectfully submitted,

ROBERT E. SMITH
Executive Director

TRANSMITTAL TO COUNCIL:

WALTER J. SLIPE
City Manager

Contact Person: Tom Lee 440-1357

RES:JC:plf

2774D

RESOLUTION NO.

ADOPTED BY THE SACRAMENTO CITY COUNCIL

ON DATE OF ____________________________

POLICY ON CURRENT REFUNDINGS OF MULTIFAMILY
HOUSING PROJECTS BASED ON ECONOMIC DISTRESS

BE IT RESOLVED BY THE SACRAMENTO CITY COUNCIL:

Section 1: The policy and criteria set forth in Attachments A and B for the evaluation of proposed refunding of multifamily bonds for housing projects are adopted.

____
MAYOR

ATTEST:

____
CITY CLERK

1100WPP2(542)

FOR CITY CLERK USE ONLY

RESOLUTION NO.: ______________

DATE ADOPTED: ______________

Attachment "A"

POLICY AND CRITERIA FOR EVALUATION OF BOND REFUNDING

OF DEFAULTING MULTI-FAMILY RESIDENTIAL PROJECTS

The following procedures and criteria shall be used to evaluate bond refundings of a defaulting residential property:

1. SHRA will accept for consideration proposals to refund bonds under the default provisions of the bond documents only after the subject project lender issues to the property owner and files with the County Recorder a Notice of Default. The recording of the Notice of Default provides for a ninety day period prior to sale of the property through foreclosure.

2. To request consideration of refunding bonds based on a default, the property owner must submit a letter to SHRA including:

   a. documentation of the actions taken by the property owner and lender to cure the default;

   b. documentation of the economic distress of the project including operating and cash flow statements for each of the six months prior to the date when the Notice of Default was issued;

   c. the reasons for the project being in an economic condition which led to the defaulting on the mortgage;

   d. a citation of the provisions of the bond documents which would allow for a default based refunding of the bonds;

   e. a copy of the recorded Notice of Default issued by the lender;

   f. projections of project market rate and twenty percent set-aside rents for the next three to five years;

   g. copies of certified audited financial statements of the project general partner and limited partnership, if any;

   h. the property owner's proposal for the term and rate of the reissued bonds and the provisions for extension and changes to the regulatory agreement; and

   i. a check in an amount equal to .25% of the proposed bond reissue to cover SHRA's administrative costs.

3. Upon review of the information submitted pursuant to item number two (2) above, SHRA staff and/or the Agency's bond counsel may request additional information or documents.

4. Also, SHRA staff will hold discussions with the lender regarding the subject property to determine the circumstances of the default and the steps that the lender intends to take toward foreclosure.

5. Concurrently with item number four (4), staff will ask the subject property owner and lender to complete the Refunding Checklist Questionnaire. The purpose of the refunding checklist is to gather all information and documentation that is pertinent to the proposed refunding. (A copy of the checklist is enclosed as Attachment "B.")

6. Upon receipt of the completed questionnaire and requested documentation, including information from the lender with respect to their plans to foreclose on the project, Agency staff will review the information related to the project.

7. Also, a consultant will be hired (at the property owner's expense) to provide a third party independent analysis of the financial condition of the project and project owners including general and limited partners. The purpose of the analysis is to determine if it is reasonable that a condition of economic distress exists, and whether the condition is due to temporary conditions or circumstances of a long-term nature. Also, staff will analyze the amount of owner/investor equity in the project and the steps that the owner/investors have taken to reverse negative cash flow conditions.

8. Concurrently, legal counsel will review original bond documents and loan and partnership agreements to determine if the project owner is complying with the default provisions.

9. After reasonable investigation to determine whether the economic default can be sufficiently and factually established and after consultation with bond counsel and SHRA's investment banker, Agency staff will make a determination as to whether or not to recommend the proposed current refunding of the bonds. Where the project does not meet the default tests, in the opinion of Agency staff, the property owners will be sent a written notice that will include staff recommendations as to the options available to

the property owners relative to bond financing, such as consideration of bond refinancing at the next optional prepayment date.

10. Where Agency staff finds that the facts, as presented by the property owner, indicate that the project is in economic default, and that the project owner has exhausted all possibility of curing the default, staff will communicate, in writing, that determination to the property owner and then enter into negotiations regarding the terms and conditions of the refinancing and the regulatory agreement.

11. Agency staff will require indemnity from the property owner and/or credit enhancer, most likely in the form of a Letter of Credit in the amount equivalent at least to the prepayment penalty on the bonds, plus any applicable accrued interest amounts.

12. If a bond refunding is pursued, the project's loan to value ratio shall not exceed 80% of the appraised value of the housing project and debt service coverage shall be at least 1.10.

13. As a condition of bond refunding, Agency shall require additional regulatory concessions from the property owner which shall depend upon the economic condition of the project. As a minimum requirement, regulatory terms shall be increased to fifteen or twenty years or to the term of the longest bond(s), depending upon the number of affordable units provided in the project. In addition, the twenty (20%) percent set-aside units shall be divided between thirteen (13%) percent for low income (80% of median) households and seven (7%) percent for very low income (50% of median) households, in conformance with local policy adopted November 1985 or, the number of affordable set-aside units shall be increased above the twenty (20%) percent legal minimum.

14. Fees - Agency (.25 basis points administrative fee and .12 basis point annual fee) and SHRA bond counsel legal fees covering the costs of reviewing proposed bond refundings shall be charged on a non-contingent basis.

Attachment "B"

SACRAMENTO HOUSING REDEVELOPMENT AGENCY

DEFAULT - CURRENT REFUNDING EVALUATION CHECKLIST

TO:

FROM:

DATE:

In order to assist you in determining whether previously-issued tax-exempt bond issues in which you participated can be refunded currently, we have prepared this checklist. In addition to filling out this questionnaire, we welcome you to attach any narrative description of projects financed with such existing bonds, including the history relating to loan difficulties. We also are seeking to obtain information with respect to your Association with this questionnaire. Please provide us any narrative description with respect its operating history together with your most recent audited financial statement in addition to answering the questions set forth in this questionnaire.

The last page of this questionnaire contains a list of documents which we request you supply to both persons listed below, together with a completed and executed copy of this Default - Current Refunding Evaluation Checklist.

One copy of this questionnaire should be filled out for each project so that we can review each project and the bond documents relating to it separately. If you have more than one project, you only need to supply financial information with respect to the Association in one questionnaire and need not duplicate such answers.

RETURN TO: ______________________________

____

PROJECT INFORMATION

1. Name and address of project - ______________________

____

____

2. Number of units - ______________________

3. Dollar amount of bond-financed project loan -

______________ $______________

(original amount) (current balance)

4. Name of original project loan borrower and each general partner

____

____

____

5. Project loan interest rate - ______% (prior to any modification)

6. Does/did Association have any ownership interest in project? Yes ______ No ______. If "Yes", explain nature of interest and enclose copy of document conferring such interest - ______

____

____

7. Has project loan been modified? - ___ Yes ___ No (chec[k] one)

Describe any modification to project loan (and attach cop[ies] of any modification) - ______________________________

____

____

____

8. Has there been financial default under project loan?

___ Yes ___ No (check one)

If "Yes," list the date and the amount of each misse[d] payment and amount of total delinquencies, enclosing an[y] notice to and correspondence from project owner

____

____

____

9. If the previous answer is "No," has there been any evidenc[e] of financial difficulty at the project? ___ Yes ___ N[o] (check one)

If "Yes," describe evidence of difficulty, enclosing copie[s] of any annual or monthly operating statements - ______________

____

____

____

10. Has any person guaranteed any portion of the project loan?

___ Yes ___ No (check one)

If so, give name of guarantor, and if guarantor is an entity, give names of all individuals comprising such entity and describe dollar amount, nature of and termination date of such guarantee and <u>enclose copies of such guarantees</u> -

11. Has the project loan borrower filed for bankruptcy?

___ Yes ___ No (check one)

If so, give date of filing, court and status of the proceeding -

12. Has any general partner of the project loan borrower or any guarantor of the project loan filed for bankruptcy?

___ Yes ___ No (check one)

If so, give name of general partner or guarantor, as applicable, date of filing, court and status of the proceeding -

13. Has the project loan been foreclosed? ___ Yes ___ No (check one)

If "Yes," give name of project purchaser, purchase price and method of purchase price payment, enclosing any sale and loan documents relating to such purchase

___

___

___

14. Is project now "real estate owned"? ___ Yes ___ No (check one)

If "Yes," give amount of reserves established for project and state whether any appraisal has been performed -

___

___

___

15. Has project been sold? ___ Yes ___ No (check one)

If "Yes," give name, address and general partner of purchaser - ___

___

___

16. Was the project loan modified or a new loan made in connection such sale? ___ Yes ___ No (check one) Enclose a copy of any loan modification agreements or the new loan agreement, as applicable.

17. Did purchaser take property "subject to" existing loan, enter into "wrap" note or assume existing project loan? - ____

____

____

18. State current annual net operating income of project available for debt service as dollar amount and as a percentage of outstanding project loan balance - $__________/______%

19. State dollar amount of principal reduction of project loan now held by Association - $ __________

20. State amount of principal amortization not used to redeem bonds - $__________

THE ASSOCIATION

21. Name and address of Association - ____________________

____

____

22. Name and telephone number of principal contact person for refunding bond issues - ____________________

____

23. Name, address and telephone number of Association's counsel who would be retained in connection with refunding transaction - ____________________

____

____

24. Name, address and telephone number of Association's outside accountants - ____________________

____

____

25. Type of credit device used for old bonds(check one):

____ CD

____ Collateralized Lender Note

____ Lender Letter of Credit

____ Other (decribe)

26. Dollar amount of Association's credit device - $__________

27. Is the Association subject to any (check if applicable):

____ Supervisory Agreement ____ Cease and Desist Order

____ Plan of Liquidation ____ Conservatorship

If so, please describe and enclose copy - ____________________

____

____

28. Is the Association supervised under FSLIC's management consignment program"? _____ Yes _____ No (check one)

29. Does Association have FSLIC Income Capital Certificates or Net Worth Certificates? _____ Yes _____ No (check one)

30. State the Association's current net worth - _______ %

31. Is the Association a publicly-traded company?

_____ Yes _____ No (check one)

If "Yes," enclose copy of most recent annual and quarterly report.

32. Please describe any internal, state or federal regulatory approvals which will be required to make new loan to refinance project, finance costs of issuance and consummate refunding issue

____

____

____

____

____

____

EXISTING BONDS

33. Dollar amount and title of existing bond issue - ________

____

____

34. Date of issuance - ________________________

35. Original underwriters (as listed on Official Statement) -

____

____

36. Maturity date(s) of existing bonds (include serial maturities)

____

____

37. Dollar amount of existing bonds now outstanding (by maturity)

____

38. Interest rate on each maturity of bonds - ____________

____

39. Amount on deposit in Debt Service Reserve Fund? $________, constituting ________ days interest on existing bonds

40. Name, address, contact person and telephone number of original trustee for existing bonds - ____________________

____

____

41. Name, address, contact person and telephone number of original bond counsel for existing bonds - ____________________

____

____

****

I hereby certify that the information provided in this Refunding Checklist is complete and accurate to the best knowledge of the Association and that the underwriters are entitled to rely upon the accuracy and completeness of such information in connection with the offering sale and issuance of refunding bonds.

____
(name of association)

Date: ____________________ By: ______________________________
Title:

****

DOCUMENTS

Please provide us copies of the execution form of any of the following documents for this project financing (check applicable documents):

BOND DOCUMENTS

_____ Trust Indenture
_____ Certificate of Deposit
_____ Letter of Credit
_____ Deposit Agreement
_____ Lender Note
_____ Surety Bond
_____ Collateral Escrow Agreement
_____ Reimbursement Agreement
_____ Official Statement

PROJECT DOCUMENTS

_____ Project Loan Agreement/ Development Agreement
_____ Promissory Note
_____ Loan Modifications(s)
_____ Project Owner Guarantee
_____ Deed of Trust/Mortgage
_____ Regulatory Agreement Deed Restrictions
_____ Project Sale Agreement

LENDER DOCUMENTS

_____ Supervisory Agreement
_____ Cease and Desist Order
_____ Receivership/ Conservatorship Order

mbs/docs/rfd.chklst

Attachment "C"

There are six different types of Regulatory Agreement requirements relating to income and rent requirements of each project. The requirements are based upon the date bonds were issued for each project. The requirements, as outlined in the Agency's <u>Multi-family Housing Revenue Bond Program Procedures Manual</u> revised February 1, 1989, are summarized as follows:

1. 20% Low/Moderate/State Rent Restrictions

   A. 20% of project's units for tenants with gross income of 80% or less of area median income based on family size.

   B. Monthly rent cannot exceed 1/12th of 30% of 80% of median income based on family of four.

2. 10/10% Occupancy - No rent ceiling but 20% of units must be for low/moderate income households. Also, project managers must make a good faith effort to rent at least half of its set-aside units, or 10%, to very low income (50% of median) tenants. All set-aside units must be for tenants with incomes at or below the 80% of median level.

3. 7/13% Occupancy - Local Rent Policy - In 1985, the City Council and the County Board of Supervisors adopted a local policy to make at least 7% of project units available to very low income households. Thirteen percent (13%) of the units must be rented to low/moderate income tenants who pay no more than 30% of 80% of median income based on family size. (See attached chart of applicable rents.)

4. Special Rent Restrictions - Three projects have special rent restrictions:

   A. **Woodlake Close** - 20% of units for low/moderate income tenants with no rent restriction.

   B. **Creekside** - 10% of units for very low income tenants where rents are not to exceed 30% and 50% of median income. Another 10% of units are for low/moderate income households with no rent restrictions.

   C. **Fairways Phase II** - 10% of units for very low income not to exceed Section 8 Fair Market Rents, and 20% of the units to low/moderate income tenants with incomes not exceeding 30% to 50% of median income as adjusted for family size, less utility allowance.

Attachment "C"

7/13% LOCAL RENT RESTRICTION

A. The following rent restrictions apply to projects subject to the 7% very low income local rent policy.

COUNTY SECTION 8 FAIR MARKET RENTS - 7% of units in complex

0 bedroom	\$364 - \$25 = \$339
1 bedroom	\$434 - \$32 = \$407
2 bedrooms	\$519 - \$43 = \$476
3 bedrooms	\$754 - \$60 = \$694
4 bedrooms	\$800 - \$71 = \$729

CITY SECTION 8 FAIR MARKET RENTS - 7% of units in complex

0 bedroom	\$364 - \$29 = \$335
1 bedroom	\$434 - \$36 = \$398
2 bedrooms	\$519 - \$48 = \$471
3 bedrooms	\$754 - \$67 = \$687
4 bedrooms	\$800 - \$79 = \$721

B. The following rents apply to the 13% low/moderate income local rent policy. Rent cannot exceed 30% of 80% of median, indexed to family size, less a utility allowance.

COUNTY:

0 bedroom	\$472 - \$20 = \$452
1 bedroom	\$538 - \$26 = \$512
2 bedrooms	\$606 - \$34 = \$572
3 bedrooms	\$671 - \$48 = \$623

CITY:

0 bedroom	\$472 - \$23 = \$449
1 bedroom	\$537 - \$29 = \$508
2 bedrooms	\$605 - \$38 = \$567
3 bedrooms	\$672 - \$54 = \$618

These rent requirements only apply to certain projects. Consult the Regulatory Agreement on your project to determine if your project is subject to these rent requirements.

*All rents are effective as of 10-1-88 and subject to change with the release of new fair market rents or median income limits.

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