

DATE ISSUED: November 12, 2003

REPORT NO. RA-03-36
CMR-03-224

ATTENTION: Honorable Chair and Members of the Redevelopment Agency
Honorable Mayor and Members of the City Council
Docket of November 18, 2003

SUBJECT: Tax Allocation Bond Issues for the City Heights and North Park
Redevelopment Project Areas

SUMMARY

Issues - Should the Redevelopment Agency and the City Council:

- 1) Authorize the issuance of 2003 Housing Set-Aside Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for City Heights in a total amount not to exceed \$7 million, and approve necessary financing documents?
- 2) Authorize the issuance of 2003 Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for North Park in a total amount not to exceed \$13 million, and approve necessary financing documents?
- 3) Amend the Fiscal Year 2004 Redevelopment Agency budget to authorize:
 - a) The appropriation and expenditure of \$1,525,000 from the North Park Series 2003A bond proceeds for the Renaissance at North Park project (Fund 98308), contingent on the successful completion of the bond sale and receipt of funds?
 - b) The appropriation and expenditure of \$675,000 (plus interest) from the proposed North Park Series 2003A Bonds for the repayment of the developer loan from San Diego Interfaith Housing for the Renaissance at North Park project (Fund 983084), contingent on the successful completion of the bond sale and receipt of funds?
 - c) The appropriation and expenditure of \$2.8 million from the proposed City Heights Series 2003A bonds for the repayment to San Diego Revitalization Corporation for the Metro Villas Gap Loan (Fund

98229), contingent on the successful completion of the bond sale and receipt of funds?

Executive Director's/City Manager's Recommendation - That the Redevelopment Agency and the City Council:

- 1) Authorize the issuance of 2003 Housing Set-Aside Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for City Heights in a total amount not to exceed \$7 million, and approve necessary financing documents.
- 2) Authorize the issuance of 2003 Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for North Park in a total amount not to exceed \$13 million, and approve necessary financing documents.
- 3) Amend the Fiscal Year 2004 Redevelopment Agency budget to authorize:
 - a) The appropriation and expenditure of \$1,525,000 from the North Park Series 2003A bond proceeds for the Renaissance at North Park project (Fund 98308), contingent on the successful completion of the bond sale and receipt of funds.
 - b) The appropriation and expenditure of \$675,000 (plus interest) from the proposed North Park Series 2003A Bonds for the repayment of the developer loan from San Diego Interfaith Housing for the Renaissance at North Park project (Fund 983084), contingent on the successful completion of the bond sale and receipt of funds.
 - c) The appropriation and expenditure of \$2.8 million from the proposed City Heights Series 2003A bonds for the repayment to San Diego Revitalization Corporation for the Metro Villas Gap Loan (Fund 98229), contingent on the successful completion of the bond sale and receipt of funds.

Other Recommendations – The City Heights Redevelopment Project Area Committee voted on October 13, 2003 to recommend approval of the issuance of tax allocation housing bonds for City Heights in a total amount not to exceed \$4.0 million. Subsequently, on November 4, 2003, the City Heights PAC Housing Subcommittee voted unanimously to increase the size of the housing bond for additional funds in the amount of \$1.3 million to be obtained for contribution to the Ken-Tal Senior Housing Project. The North Park Redevelopment Project Area Committee voted on October 14, 2003 to recommend approval of the issuance of tax allocation bonds for North Park, for both housing and general redevelopment purposes, as proposed.

Fiscal Impact – The 2003 Housing Set-Aside Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for City Heights will not exceed \$7 million aggregate principal amount, with annual debt service payments estimated at \$500,000 to come from low- and moderate-income housing funds. The 2003 Tax Allocation Bonds, Series A (taxable) and Series B (tax-exempt) for North Park

will not exceed \$13 million aggregate principal amount, with annual debt service payments estimated at \$880,000 for years 1 through 27, and increasing to \$1.5 million in 2031. Payments are to be made from tax increment and low-and moderate-income housing funds. The bonds are secured by the tax increment revenue generated by each respective redevelopment project area. An independent fiscal consultant report has been prepared for each project area and concludes that sufficient tax increment revenue is currently and will continue to be generated on an annual basis to support annual debt service payments.

BACKGROUND

CITY HEIGHTS PROJECT AREA

In April 1999, the Redevelopment Agency issued two series of bonds totaling \$15.8 million for the City Heights Redevelopment Project Area for the purpose of providing funds for property acquisition and related relocation costs for the City Heights Urban Village Neighborhood Retail Center. Because the assessed valuation of the project area was below base and the project area was not generating any tax increment at the time the bonds were issued, several unique strategies were put in place to make the unrated financing successful, and to provide funding for the larger Urban Village project. These strategies included:

- Deferral of initial bond principal payments and then significant escalation in the payment schedule from a low of \$316,000 in Fiscal Year 2002 to maximum of \$2.3 million in Fiscal Year 2029.
- Restriction on use of all City Heights discretionary tax increment (net of housing and tax-sharing requirements) from the date the bonds were issued through September 2003, instead placing funds in reserve, to ensure sufficient funds would be available when the increasing principal payments would begin.
- Suspension by the City of its right to receive its portion of tax increment revenues until the bonds are fully paid in Fiscal Year 2029, instead letting the Agency receive those funds to contribute to bond payments, providing additional security to bondholders that payments will be made. This revenue has amounted to a total of \$1.6 million for the period of Fiscal Years 2000 to 2003, and is approximately \$500,000 annually and is projected to grow to \$2.2 million annually in Fiscal Year 2029.
- Institution of a ‘float’ loan by the City in the CDBG program to provide \$2.2 million to the City’s Urban Village project to be repaid by 2008.
- Inclusion of a lengthy call period on the bonds, which effectively prohibits the Agency from defeasing the bonds for fifteen years, adding further protection to the bondholders. With the current low interest rate environment, if bonds were issued now to refinance the Series 1999 Bonds, the required escrow account

would lose money during the ensuing eleven year period, resulting in added costs for refinancing and the need to borrow more making it prohibitively expensive, and thus infeasible.

- An additional bonds test for the Series 1999 Bonds requiring the Agency to show its ability to fund the maximum annual debt service at 1.25 times, prior to the issuance of any new bonds pledging the same tax increment stream as repayment. Since the Series 1999 Bonds have an escalating debt schedule, the maximum annual debt service of \$2.3 million requires the Agency to show available annual discretionary tax increment of \$2,875,000, in order to issue additional parity bonds. Based on current estimates, available annual discretionary tax increment is approximately \$2,180,000 for Fiscal Year 2004.

These credit enhancements contributed to the successful offering of the Series 1999 Bonds, and allowed the Agency to sell the unrated, uninsured bonds with true interest costs of 5.88% and 6.30%. However, these factors also contribute to the Agency's inability to refund or refinance the Series 1999 Bonds, and from issuing additional parity bonds for general redevelopment purposes for the City Heights project area. The Agency will pursue alternative financing mechanisms, including subordinate bonds or other long-term debt options, as project activities increase and may require substantial Agency assistance which may exceed funding available on a pay-as-you-go basis. As tax increment is likely to continue to grow in the coming years, the project area may have sufficient discretionary resources to meet the necessary tests for additional bonds to be issued in the near future.

The Series 1999 Bonds were issued on a tax-exempt basis. In May 2002, the Internal Revenue Service provided notice to the Redevelopment Agency that it had selected the City Heights bond issuances for a routine review to determine compliance with Federal tax requirements. The City Auditor and Comptroller and the City Attorney recommended that specialized outside tax counsel with experience in these matters be retained to advise the Agency and act as the Agency's representative to the Internal Revenue Service. Following the provision of detailed documentation of the bond funded expenditures, a full accounting of the bond funds and related interest earnings, explanations of the Agency's role to facilitate redevelopment, in general, and specifically with regards to the bond funded project, and a visit to the project site, the Agency was notified in August 2003 that the IRS had concluded its examination and recommended no change to the tax-exempt status of the bonds.

Annual tax increment receipts for the City Heights project area are well above previous projections, in excess of \$5.0 million annually, however, the inability to use tax increment during the reserve period has resulted in pent up demand in the project area for project financing. Additionally, 20% of these funds are required to be set-aside for housing purposes, and approximately 35% is shared with the other taxing agencies in the project area. After these requirements and the payments on the Series 1999 Bonds, approximately \$1.7 million remains for Agency project management, for contribution to projects, and to fund other obligations already in place.

Major demands on the tax increment reserve, which exceeds \$4.2 million, and newly available annual tax increment include:

- Agency repayment of \$2.2 million to the CDBG program to eliminate the float loan for the Urban Village project; this obligation is included in the Fiscal Year 2004 Redevelopment Agency Budget to be fully repaid from the City Heights project area from its tax increment revenue.
- Agency obligation to repay San Diego Revitalization Corporation for the Metro Villas Gap Loan in the amount of \$2.8 million by December 2003. An agreement is in place which pledges the Agency's tax increment reserve unless another source of funding is identified. The Fiscal Year 2004 Redevelopment Agency Budget includes the payment of this obligation from general City Heights tax increment revenue.
- Agency obligation to City for over \$2 million in staff costs from over the last three years for Redevelopment, Attorney and Auditor costs - not yet recorded as Agency debt to the City. \$500,000 has been included in the Fiscal Year 2004 Redevelopment Agency budget to be repaid from the City Heights project area.
- Project financing needs that are estimated to exceed \$25 million over the next three to five years, though most are not yet formal commitments

While the Agency is unable to issue parity bonds for City Heights from its tax increment available for general redevelopment purposes (80% funds), similar obstacles do not exist on its housing funds.

AFFORDABLE HOUSING

On August 6, 2002, the City Council approved the concept of leveraging the Agency's Low- and Moderate-Income Housing set-aside funds to create up to \$55 million in affordable housing financing to fund the Affordable Housing Collaborative Notice of Funding Availability (NOFA). In January 2003, the Agency approved the NOFA to seek proposals to develop new affordable housing units within the City of San Diego. The City's Redevelopment Division is working with the Centre City Development Corporation (CCDC), the Southeastern Economic Development Corporation (SEDC) and the Housing Commission to implement projects submitted in response to the NOFA. Nine project submissions have been received and are in various stages of review and negotiation. On June 3, 2003, the Agency authorized the issuance of Horton Plaza Redevelopment Project Tax Allocation Housing Bonds, Series 2003C in an amount not to exceed \$7.6 million as the first part of CCDC's commitment of contributing \$40 million towards the total Agency housing funding of \$55 million. The redevelopment project areas administered by the City Redevelopment Division expect to provide the remaining \$15 million. The proposed tax allocation bond issuance for the City Heights project area would be the initial effort by the City Redevelopment Division to fund a portion of its NOFA obligation. The Ken-Tal Senior Housing Project, currently under review through the NOFA process, is located within the City Heights project area. Agency assistance of approximately \$4.0 million has been requested. This project is expected to come forward

for Agency review and approval in the following weeks, and a portion of the requested subsidy could be provided from the City Heights housing funds.

Current commitments on the City Heights housing funds include the repayment of a promissory note to San Diego Revitalization Corporation related to Agency assistance provided for the City Heights Townhomes and Office project. Under the current terms of the Disposition and Development Agreement and the related promissory note, the developer is entitled to annually receive over 33% of the total project area’s housing funds, towards the repayment of \$5.115 million, plus 5% annual interest. The current promissory note constitutes a first-priority pledge on this portion of the project area’s housing funds, which cannot also be pledged towards the repayment of bonds. An effort to subordinate the project developer’s rights to the annual repayments on the proposed bond to allow for a larger bond issuance has been unsuccessful. The Fiscal Year 2004 payment is estimated at \$335,000 and will increase each year based on actual tax increment receipts for the project area.

The City Heights Project Area has initiated the “Home in the Heights” First Time Homebuyers program, allocating housing funds to provide assistance to homebuyers in the City Heights area. Nine loans have been completed over the past several months, with more in process. Recently, a Housing Rehabilitation program has been authorized in the amount of \$350,000. Applications for these funds have already significantly exceeded the amount authorized. It is desired to increase the funding for both programs to meet the needs of the project area.

Listed below is a summary of the housing project needs for the City Heights project area proposed to be funded from the Series 2003 bonds.

City Heights Projects – Housing Bond Needs	Taxable	Tax-Exempt
	2003A	2003B
Metro Villas Gap Loan Repayment	\$2,800,000	
Ken-Tal Senior Housing (NOFA)	\$1,500,000	
Housing Rehabilitation/First Time Homebuyers Programs		\$750,000
Total Projected Needs	\$4,300,000	\$750,000

NORTH PARK PROJECT AREA

In October 2000, the Redevelopment Agency issued tax-exempt Tax Allocation Bonds for the North Park Redevelopment Project Areas (the Series 2000 Bonds). The Series 2000 Bonds provided net proceeds in the amount of \$6.3 million and included funds leveraged from the project area’s housing funds. The Series 2000 Bonds were rated Baa1/BBB+, by Moody’s and Standard and Poor’s, respectively, and were competitively sold with a true interest cost of 5.81%.

Under the existing trust indenture for the Series 2000 Bonds, additional (parity) bonds can be issued only when sufficient tax increment revenues are available in excess of 1.5 times the annual debt payments. Due to the fact that the top five taxpayers within the project area represented over 20% of the incremental assessed valuation of the project area at the time the Series 2000 Bonds were issued, this represented a higher than desirable level of concentration in the ownership composition of the project area, therefore requiring a higher than typical level of debt service coverage, usually at 1.25 times the annual debt payments. When ownership concentration has been reduced to the extent that the top five taxpayers comprise less than 20% of the incremental assessed valuation, the debt service coverage requirement is then reduced to the 1.25 level. For Fiscal Year 2004, this condition has been met, allowing the coverage requirement on the existing bonds to be reduced. Because of this, additional bonds are proposed to be issued under the existing Series 2000 Bond structure, with the prior documents being amended as needed to provide for the issuance of more bonds.

As of October 2003, approximately \$3.7 million of the North Park bonds are uncommitted. Projects in negotiation and those under agreement are expected to require all of the funds on hand, as well as funds to be received from the proposed bond sale.

On August 5, 2002, the Agency approved a Disposition and Development Agreement (DDA) for the Renaissance at North Park project, and authorized the expenditure of \$1,800,000 from Series 2000 Bond funds. In addition, the San Diego Interfaith Housing Foundation (project co-developer) provided a loan of funds to the Agency in the amount of \$675,000 to assist with the interim funding needs of the project. The DDA contemplates Agency assistance up to a total of \$4.0 million, and provided that the additional funds beyond the \$2,475,000 immediately committed, eventually come from the proceeds of the Agency's next North Park tax allocation bond, or could be advanced by the developer and repaid when sufficient Agency funds became available. Property acquisition and relocation efforts for the project are being completed. Project construction is expected to be underway in early 2004, and the project developers have requested the remaining Agency funds of \$1,525,000 to be made available as soon as possible. In addition, the loan to San Diego Interfaith Housing Foundation is payable in full in December 2003. It is recommended that the Agency budget be amended, contingent on the receipt of the bonds funds to allow for the immediate expenditure of the remaining funds authorized under the DDA, provided all requirements under the agreement have been met, and to authorize repayment of interim loan. Due to the other sources of project financing, the Agency's remaining funds will be provided from taxable bonds proceeds, eliminating the ability of the Agency to utilize its tax-exempt bond funds on hand for this purpose.

The Agency is finalizing negotiations towards a Disposition and Development Agreement for the development, construction and operation of the North Park Parking Structure, in order to provide needed parking related to the North Park Theatre rehabilitation and the surrounding area. According to the proposed terms, the Agency plans to provide funds for property acquisition and project construction up to \$7.5 million, with the developer contributing up to \$2.0 million. The Agency intends to utilize

up to \$2.8 million from the Series 2000 Bonds currently on hand. The remaining Agency obligation of \$4.7 million is proposed to come from the North Park Series 2003 Bonds. Due to the nature of the proposed uses of the parking structure, a portion of which will include private use and benefit to private interests, the Agency will be required to contribute a portion of its funding on a taxable basis, increasing its costs of borrowing for this purpose. To the extent the parking structure will be for use by, available to, and benefit the public, the Agency's contribution for that portion can be financed with tax-exempt bonds. It is anticipated that the DDA related to the parking structure will be scheduled for Agency review and approval in the coming weeks.

To help facilitate the rehabilitation of the North Park Theatre, and to provide replacement parking due to the development of the North Park Parking Structure, additional surface parking is proposed to be developed in the near term. Original cost estimates for land acquisition and development of additional surface parking total \$1,240,000, which was planned to be funded from \$900,000 in CDBG funds previously loaned to the Agency and \$340,000 from the North Park Series 2000 bonds. Due to increased costs related to property acquisition, potential tenant relocation and development costs, total project funding is expected to reach \$2.2 million, necessitating an additional \$1.0 million Agency contribution.

Additional obligations and increased costs related to the North Park Theatre rehabilitation project, in addition to public improvements in the vicinity of the Theatre and parking structure projects are also anticipated to ensure the successful implementation of both important priority projects by the January 2005 target completion date.

Listed below is a summary of the project financing needs for the North Park project area, showing the use of existing and proposed bond funds.

North Park Projects- New Bond Funds	Funds On Hand	Proposed Bond Funds			Total 2003 Bonds	Total Project (Agency costs)
		Housing	General Redevelopment			
	2000 Bonds/ CDBG	Taxable 2003A	Taxable 2003A	Tax-exempt 2003B		
Parking Structure	\$2,800,000		\$1,100,000	\$3,608,000	\$4,708,000	\$7,508,000
Surface Parking	\$1,240,000			\$1,000,000	\$1,000,000	\$2,240,000
Renaissance DDA SDIFH Repayment		\$1,525,000 \$675,000			\$2,200,000	\$2,200,000
Theatre/Public Improvements			\$2,000,000		\$2,000,000	\$2,000,000
Private Development Projects (Residential)	\$600,000	\$275,000			\$275,000	\$875,000
Total	\$4,640,000	\$2,475,000	\$3,100,000	\$4,608,000	\$10,183,000	\$14,823,000

Projects and expenditures not yet authorized by the Redevelopment Agency will be scheduled for review by the respective project area committees, receive appropriate environmental analysis and review, and come forward at a future meeting of the Redevelopment Agency to seek appropriate approvals. Intentions on the use of funds are shown here for planning purposes, to demonstrate the Agency's need for the borrowed funds and that a reasonable expectation exists that all borrowed funds will be expended within a three year period as required by Federal tax law.

Both the City Heights and North Park Project Area Committees (PAC) have received presentations regarding the issuance of bonds, including the financial status of the project areas demonstrating the ability to support the proposed bond issuances, and the expected uses of the bond proceeds. On October 13, 2003, the City Heights PAC recommended that the Agency issue bonds for the City Heights Project Area, in an amount not to exceed \$4.0 million. Subsequently, on November 4, 2003, the City Heights PAC Housing Subcommittee voted unanimously to increase the size of the housing bond for additional funds in the amount of \$1.3 million to be obtained for contribution to the Kental Senior Housing Project. On October 14, 2003, the North Park Project Area Committee voted to recommend that the Agency issue bonds for the North Park Project Area for both housing and general redevelopment purposes, as proposed by the Agency.

FINANCING ASSUMPTIONS

Agency staff and City departments including the City Treasurer, the City Auditor and Comptroller, and the City Attorney have been working in a team approach with the Agency's consultants, including its financial advisor, Kitahata & Company, bond counsel, Best, Best & Krieger, and fiscal consultant, David Taussig & Associates, to prepare the appropriate documents and reports, and to structure the financing plans, considering credit, legal and tax issues.

Bonds for both project areas are being issued simultaneously to allow for significant cost savings in jointly preparing the documents and developing the financing plans. In addition, selling the four separate issues for the two project areas at one time increases the total size and attractiveness to investors who may have not shown interest in the individual, smaller offerings. The bonds will be sold on a competitive basis, and are secured by the tax increment revenue generated by the respective redevelopment project areas. The proceeds, as well as the debt service payments resulting from the sale of the bonds, will accrue to each separate project area and will not be combined.

The ratings process has been initiated and bond insurance is being sought, with a first-time rating requested for the City Heights project area. An enhanced rating for North Park from the prior Series 2000 rating is expected, due to the improved economics, increased assessed valuation and tax increment receipts, and a reduction in the ownership concentration in the project area since the prior issue. Estimated interest rates for the taxable series are significantly higher than the tax-exempt portions, but could be reduced if bond insurance is obtained. At present, estimates for true interest costs for the various series of bonds range from 5.67% (tax-exempt) to 9.05% (taxable).

The proposed bond sales require the adoption of resolutions authorizing the issuance of the various series of bonds and the approval of the following preliminary documents:

1. Preliminary Official Statements – A detailed offering circular informing potential bond purchasers of all relevant information as to the nature of the obligations, the projects to be financed and the security of the bonds for each project area.
2. Trust Indenture – Trust Indenture between the Agency and BNY Western Trust Company, as trustee providing for the terms and conditions of the Agency’s relationship with the bond trustee, providing instructions to the trustee for the establishment of necessary accounts and for payments to bond holders for the City Heights bonds.
3. First Supplement to the Trust Indenture – Supplement to the existing trust indenture between the Agency and Wells Fargo, current trustee of the North Park Series 2000 bonds, providing additional terms and conditions and new accounts and payments related to the additional bonds for the North Park project area.
4. Continuing Disclosure Agreements – Agreements by the Agency for the benefit of the bondholders to disclose certain financial and operating data each year pursuant to Rule 15c2-12(b)5 of the Securities and Exchange Act for each bond issue. These annual reports will be made available on the City’s website, as well as distributed as required to the Municipal Securities Rulemaking Board (MSRB), and Nationally Recognized Municipal Securities Information Repositories (NRMSIRs).

ISSUANCE SCHEDULE

Upon authorization to issue the bonds by the Redevelopment Agency and the City Council, the bond issuance process will move forward according to the following schedule:

<u>Date</u>	<u>Activity</u>
November 21, 2003	Mail Preliminary Official Statement
December 4, 2003	Competitive Sale of Bonds
December 8, 2003	Mail Final Official Statement
December 17, 2003	Closing/Receipt of Proceeds

ALTERNATIVE

Do not approve the issuance of bonds for the City Heights and North Park
Redevelopment Project Areas. Do not amend the Fiscal Year 2004 Redevelopment
Agency budget for the Renaissance at North Park and City Heights Metro Villas Projects
as recommended.

Respectfully submitted,

Todd Hooks
Deputy Executive Director
Redevelopment Agency

Approved: Hank Cunningham
Assistant Executive Director
Redevelopment Agency

Approved: Bruce Herring
Deputy City Manager