Agency Rpt.

25

SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

October 27, 1982

FILED
By the City Council
Office of the City Clerk
Cont 40
11-16-82 Withdrawn
NOV 3 1982

FILED
By the City Council
Office of the City Clerk
NOV 16 1982

CITY MANAGER'S OFFICE
RECEIVED
OCT 27 1982

Sacramento City Council
Sacramento, California

Honorable Members in Session:

SUBJECT: Smoketree Square Proposal (Shearson-American Express)

SUMMARY

This report regards a proposal by the Pacific General Group, Inc., requesting the City of Sacramento to sponsor an issuance of revenue bonds to provide construction and permanent financing for a rental housing project--Smoketree Square (Attachment 1). The project requires financing of about $18 million to construct over 400 rental units in the South Natomas area.

The Sacramento Housing and Redevelopment Agency staff, at the direction of the City Council and Board of Supervisors, is currently developing a cooperative City-County multifamily rental bond program. A comprehensive Request For Proposal (RFP) process has resulted in the selection of a financing team and developer and lender participation has been solicited. It should be noted that Shearson-American Express participated in the RFP but were not selected. The City-County program can accommodate several developers and projects, including the Smoketree Square Apartment project.

For reasons stated in the following report, Agency staff does not recommend a separate City bond issue at this time to finance the Smoketree Square project.

BACKGROUND

On October 4, 1982, Pacific General Group, Inc., Developer, through a financial consultant, approached Sacramento Housing and Redevelopment Agency regarding the bond financing of a multifamily rental housing project. The developer is seeking approximately $18 million to construct over 400 apartment units near San Juan Road and Truxel Road in the South Natomas area of the City. The project is to be called the Smoketree Square Apartments. Except for the issuing entity (City versus County) and the fact that only one project would be financed (rather than more than one), the proposed financing

11-3-82
D-1

25

SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

mechanism is identical to the City-County cooperative multifamily rental housing bond program currently being developed by Agency staff. A discussion of the City-County program is contained in an informational report submitted to your body at this meeting.

With respect to the cooperative City-County rental housing bond program, the Agency has completed a comprehensive RFP process whereby a financing team has been selected. The Agency has also advertised for developer and lender participation and over 25 developers have expressed interest in receiving financing under the program. Informational meetings and discussions with developers and lenders have been held. Of the 25 developers expressing interest, 12 developers have expressed interest in financing projects in the City under this program. In brief, the cooperative City-County program is progressing in a timely manner and its success should be a priority.

In entertaining a proposal to develop a separate City bond issue, consideration must be given to the impact of the proposed single-project financing upon the City-County cooperative issue. Should the Smoketree Square project be financed by a separate City bond issue, there is the chance that the City issue will be competing with the City-County issue in the retail bond market. Second, since the Smoketree Square bond issue may sell prior to the City-County bond issue, there is the question of fairness to the three or four developers participating in the cooperative issue who wanted bond financing weeks ago but have waited for the completion of the RFP process and formation of the financing team. Third, sponsorship of a separate City bond issue may cause developers currently in the City-County program to drop out, form their own financing teams, and pursue separate City bond issues. This scenario could jeopardize the City-County program and developers of smaller projects who do not require the minimum amount of financing required to support a single bond issue may be eliminated from participating in this financing mechanism.

The above are some considerations that weigh against sponsoring the Smoketree Square bond issue as a separate City issue. With respect to potential reasons to support a separate issue, the main reason articulated by Shearson-American Express, underwriter for the Smoketree Square financing team, and expressed by the developer's lender First Nationwide Savings (Attachment 2) is that Shearson offers a unique FSLIC/FDIC-backed Certificate of Deposit structure that is not available in the City-County program. Under this structure, proceeds from a bond sale are deposited by the bond program Trustee with a lender (federally insured savings and loan or commercial bank) who issues to the Trustee Certificates of Deposit in an amount equal to the bond proceeds received. The Certificates of Deposit are insured by the Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Deposit Insurance Corporation (FDIC). The lender then makes project loans to a developer to finance the development of apartment units. Should the project fail and the lender is unable to make payment on the principal of, or interest on, the Certificates of Deposit, then FSLIC, or FDIC, is obligated to pay to the Trustee the amounts due on the Certificates. This structure provides for a high degree of security for bond holders and the bonds command a high bond rating. Moreover, this structure avoids the alternative of requiring lenders to collateralize the loans by pledging to the Trustee a portfolio of securities--a requirement that would eliminate many potential lenders.

The above described Certificate of Deposit structure is identical to the one that Blyth Eastman Paine Webber, underwriter for the City-County bond issue, promoted in its proposal to the Agency and is the structure it is pursuing.

The other reasons for a separate City bond issue, set forth in the Shearson-American Express letter (Attachment 3), address the question of whether to undertake multifamily financings on a combined, or pooled, basis or on a project-by-project basis. Since the City and County have committed to the combined approach, at least for the initial multifamily financing, this program should be provided an opportunity to proceed without the concurrent issuance of competing bonds. The combined, or pooled, approach permits economies of scale in absorbing bond issuance costs. Furthermore, it permits bringing to the bond market one bond issue rather than a series of separate issues, each supporting a single project. The savings in administrative time can be considerable. Appropriate review and analysis of this pooled project approach will dictate how future multifamily financings should be designed.

FINANCIAL DATA

The developer, Pacific General Group, Inc., requests bond financing in the amount of approximately $18 million. Bonds sold for the purpose of providing such financing are not an indebtedness of the City or Agency. However, some direct expenses may be incurred by the issuer. Whether these costs are covered by application fees or other sources is determined through negotiation when the financing team is formed.

VOTE AND RECOMMENDATION OF COMMISSION

It is anticipated that at its meeting of November 1, 1982, the Sacramento Housing and Redevelopment Commission will adopt a motion recommending that you take the above mentioned action. In the event they fail to do so, you will be advised prior to your November 3, 1982 meeting.

25

SACRAMENTO HOUSING AND REDEVELOPMENT AGENCY

RECOMMENDATION

It is recommended that the City Council approve the staff recommendation not to act on the Smoketree Square proposal for the above reasons as summarized below:

1. The current City-County cooperative issue proposes to use the FSLIC/FDIC-backed Certificate of Deposit approach and all interested developers and lenders (including Pacific General Group, Inc., and First Nationwide Savings) are invited to apply for participation in this program;

2. Possible conflicts in bond sale of a City issue and a cooperative City-County issue;

3. Sponsoring a separate City bond issue may be unfair to developers participating in the cooperative issue; and

4. The City-County RFP process may be compromised.

Respectfully submitted,

William H Edgar

WILLIAM H. EDGAR
Executive Director

TRANSMITTAL TO COUNCIL:

Walter J Slipe

WALTER J. SLIPE
City Manager

Contact Person: Rick Vorpe

October 12, 1982

Mr. Steve Brock
321 N. Douty #322
Hanford, California 93230

Dear Steve:

Enclosed are the materials you requested and a more recent update on Smoketree Square.

As you are aware, Pacific General Group, Inc. has applied for a "special permit" to modify an existing tentative map. The modifications are to the phase lines, elevations, floor plans and site plan. These changes are strictly esthetic and do not change the heart of the tentative map, which are the number of units and the number of phases in the project.

We are requesting approval of our Del Verde Square with modifications in the floor plans and elevations that we have determined, through the building of three phases of Del Verde, will make these units better than our original Del Verde Square product.

The request is moving through the City of Sacramento planning staff for hearing on October 28, 1982. Based on our conversations with key staff people, we do not anticipate any problem with our request and expect a favorable decision by the City Planning Commission. Gene Masuda is handling the application for the City of Sacramento planning staff.

While we are planning a project very similiar to Del Verde Square, we are reserving the right to substitute equivalent and comparable materials and brand name products, as well as minor architectural modifications subject to lender approval.

If you have any questions, do not hesitate to call me.

Sincerely,

PACIFIC GENERAL GROUP, INC.

Joe F. Jimenez, Jr.
Vice-President

JFJ:bkw

enclosures

cc: Robert N. Klein II
Financial Consultant

PACIFIC GENERAL GROUP, inc
3750 Auburn Blvd., Suite D • Sacramento, CA 95821 • (916) 488-7713

ATTACHMENT 2

25

1ST NATIONWIDE SAVINGS

James V. Harbison, SREA, CRA
Senior Vice President
Chief Loan Officer Northern Division

October 11, 1982

Mr. Andrew J. Plescia
Director of Administration
630 "I" Street
Sacramento, CA 95814

Re: Smoke Tree Square
(Pacific General Group, Developer)

Dear Mr. Plescia:

First Nationwide Savings, a Federal Savings and Loan Association, is interested in participating, as the lender, in a multi family "Loan to Lender" bond program relating to the above referenced proposed residential rental project provided that certain criteria are met.

One of the factors that this association considers in participating in such programs, is the type of security that it must provide to protect the interest of the bondholders. The association will not participate in such programs when the security consists of a pool of loans to be used as collateral as has been proposed by Blythe Eastman Payne Webber. The Shearson/American Express Plan which requires the deposit of bond proceeds in a certificate of deposit issued by the association pursuant to a Deposit Agreement is an alternative which is acceptable to the association.

Very truly yours,

James V. Harbison

James V. Harbison
Senior Vice President
Chief Loan Officer Northern Division

JVH/tf

700 Market Street, San Francisco, CA 94102 Telephone 415 772-1448

25

ATTACHMENT 3

Shearson/American Express Inc Two World Trade Center 105th Floor New York NY 10048 212 321 6745

Joseph H. Torrence
First Vice President

Received in E.D.'s Office
OCT 13 1982
SACRAMENTO HOUSING AND
REDEVELOPMENT AGENCY

October 10, 1982

Mr. William Edgar
Executive Director
Sacramento Housing & Redevelopment Agency
630 I Street
Sacramento, CA 95814

Re: Bond Financing of
Smoketree Square Apartments

Dear Mr. Edgar:

Pursuant to the suggestion of Mr. Andrew Plescia of your staff, I am writing to provide you a brief outline of Shearson's new multifamily rental housing finance program and the reasons we believe justify the City of Sacramento undertaking a bond issue for the above referenced project separate from its proposed pooled loan program.

A Preliminary Official Statement of our first financing is enclosed which I believe will provide you with a complete overview of our plan's structure and the interrelationships between the Issuer, Lender, Project Owner and the Underwriting Team. The principal steps of the plan are as follows:

1. City receives commitment agreement from Lender
2. City issues Bonds
3. Trustee receives proceeds and deposits them with the Lender
4. Lender issues to the Trustee a CD of the type insured by FSLIC or FDIC in an amount equal to the Bonds and the deposit at the same rate as the yield on the Bonds.
5. Lender makes Project Loan to the Owner at a rate of interest not to exceed 1 1/2% above yield on the Bonds.

The Shearson multifamily program is a new approach to financing multi-family rental developments and is distinguished from other similar tax exempt bond programs in that our plan principally relies on FSLIC or FDIC insured certificates of deposit as security for the Bonds. As opposed to requiring a participating lending institution to post specific collateral behind their obligation to repay the loan to them from Bond proceeds (which they in turn loan on the Project Owner), our approach of requiring only an insured CD creates significantly greater interest to participate by lending institutions. This is true because many lenders do not have acceptable collateral available to them and those that do have collateral available typically do not believe that using it in that manner will provide them the best return on those assets. Usually, those lending institutions which are willing to put up collateral will require a more significant equity participation in the project, in addition to their normal compensation in order to justify such a use of their collateral.

Our program has the added advantage of being able to generate a AAA rating by Standard & Poor's Corporation on the bonds due to the backing of the FSLIC/FDIC insured CD's. This of course would have the effect of ultimately providing the lowest possible borrowing cost to the Project Owner.

There are three principal reasons that argue in favor of undertaking a multi-family financing program on a project by project basis. Two reasons are related to the nature of the program and apply generally regardless of the financing structure, and the third reason is related to the special nature of our program.

In a combined or pooled multi-family loan program, there are often delays in aggregating all of the loan commitments to appoint were the financing plan can be implemented. This may force many projects to be unable to move to construction on a timely basis and to incur additional costs. On the other side, it may invite developers to make crucial development decisions with a very long lead time because they fear the opportunity to get financing under a program may be limited.

We believe that the minimal cost savings associated with a pooled loan financing could easily be outweighted by the costs of having to either wait for the program to be implemented, or on the other side, possibly incurring a higher financing cost than is necessary if alternatively, there was the ability to finance when a project was truly ready to go.

A second reason for allowing project by project financing is the problem that arises in any pooled loan program: the adverse impact on all Project Loans should there be an event of taxability associated with just one Project Loan. Under Section 103 (b) of the Internal Revenue Code there are certain requirements that must be satisfied on a continuing basis and if those requirements are breeched and not corrected there would be an Event of Taxability. Such an occurrance would trigger mandatory prepayment of the Project Loan, the Lender Loan and the Bonds since the interest on the Bonds would no longer be tax exempt. In a pooled loan program if there is an event of taxability with respect to one Project Loan, it would force an early prepayment of all the Project Loans in the pool since all of the Bonds would have to be redeemed. This is a risk that most Project Owners cannot afford to accept.

The nature of our plan gives rise to the third advantage of undertaking a financing on a project basis. In order to retain a AAA from Standard and Poor's, it will be necessary to limit the ownership of the Bonds of any one issue, by any one entity to $100,000. By separating the projects into individual bond issues, it will be possible for the same buyer to purchase $100,000 in each issue of bonds. The marketing advantage of that approach is obvious.

On behalf of Pacific General Group, the Developer, 1st Nationwide Savings, the Lender and Shearson/American Express Inc., for the above stated reasons, we respectfully request the City's approval and cooperation to undertake this proposed bond issue separate from the City's proposed pooled loan financing program. The Developer and the Lender believe that the Shearson program is one that works best for them and , because our development of this unique approach, we are able to respond immediately to take advantage of the a favorable bond market that presently exists, thereby assuring the Developer its needed financing at a feasible rate.

Your assistance and the City's favorable consideration with respect to this request will be sincerely appreciated.

Very truly yours,

Joseph H. Torrence

Joseph H. Torrence

cc: Robert N. Klein
Steve Brock
Jim Harbison
Hartley Hansen
Ken Jones
Bob Skiff