TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT: CITY MANAGER'S OFFICE

DATE: DECEMBER 15, 2008 CMR: 475:08

REPORT TYPE: CONSENT

SUBJECT: Approval of Amendment No. 1 to Employment Agreement with Former Director of Administrative Services Carl Yeats to Increase Interest Rate and Extend Due Date of Residential Loan

RECOMMENDATION
Staff recommends that the Council:
1) approve and authorize the City Manager to sign the attached Amendment No. 1 to the Employment Agreement between the City of Palo Alto and Carl Yeats, (former) Director of Administrative Services to increase the interest rate and to extend the due date of a residential loan and
2) authorize the City Manager, in his discretion, to extend the loan due date for an additional six (6) months at an interest rate not less than 1% above the market rate for 30 year fixed nonconforming loans in effect at the time of extension.

BACKGROUND
On May 13, 2002, Council approved: 1) an employment agreement with the then Director of Administrative Services, Carl Yeats, allowing the City to provide Mr. Yeats a housing loan; and 2) a Budget Amendment Ordinance in the amount of $800,000 to fund the acquisition of a property located at 1331 Glen Eyrie Avenue, San Jose, in accordance with the Housing Assistance Provision of Mr. Yeats' employment agreement.

Terms of the employment agreement provide for an $800,000 loan with a 30-year term. Interest on the loan for the first five years of the term is due at the lower of 5.5 percent or ¼ percent over the City portfolio rate of return, adjusted annually on a fiscal year basis. Thereafter, interest on the loan is to be paid at ¼ percent over the City's portfolio rate of return. The loan is due and payable either upon the sale of the house or within 12-months of the date of termination of Mr. Yeats' employment with the City, whichever occurs earlier.
Mr. Yeats’ employment terminated December 30, 2007, when he retired from the City.

**DISCUSSION**

Mr. Yeats has recently requested a one-year extension of his loan with the City (see attached November 21, 2008 letter). As stated in his letter, his efforts to secure a new conforming 30-year fixed rate loan have been unsuccessful. His current loan balance is approximately $707,000, and in spite Mr. Yeats’ having over 30 percent equity and very positive credit, given the current credit freeze he has been unsuccessful in his effort to privately refinance. While interest rates appear to be falling, the current market rate for a five year adjustable rate mortgage is approximately 6%. A six month extension is intended to provide enough time for the residential credit markets to improve. If the credits markets are still frozen, the City Manager will have discretion to extend the loan due date for six additional months at a rate of at least one percentage point above the market rate for 30 year fixed rate loans in effect at the time of the extension.

The City Manager acknowledges the predicament this creates for the Council. While Mr. Yeats has had a long tenure with the City and made significant contributions to Palo Alto, the City is also facing challenging financial times. Thus the City must focus on the financial aspect of this request. If the City were to request immediate repayment, it would invest the funds in treasury bonds which as of December 11, 2008 have the following yields:

<table>
<thead>
<tr>
<th>Treasury</th>
<th>Bullet Agency Yields</th>
<th>Yields</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 Month</td>
<td>0.20%</td>
<td>1.03%</td>
</tr>
<tr>
<td>1 Year</td>
<td>0.42%</td>
<td>1.33%</td>
</tr>
<tr>
<td>(extrapolated)</td>
<td>1.62%</td>
<td>3.20%</td>
</tr>
</tbody>
</table>

If the City were to extend Mr. Yeats’ loan for six months, and increase the interest rate to the current market rate for an adjustable loan of six percent, the City would be recognizing a yield well above the treasury yield and approximately 1.5 percent over its overall portfolio rate of 4.5%. From a financial perspective, this extension would result in a net revenue increase to the City.

As cash flow may become more important over time than revenue, the City Manager is recommending that the extension be split into two six month periods. If the City does not need the funds in the second six months, then the City Manager may extend the loan for one six month period. It should not be presumed that this second extension will be granted automatically and if it is granted the interest rate would be above market rate in order to incentivize prompt repayment.

The terms of this extension are contained in the attached amendment to Mr. Yeats’ employment agreement. The agreement also requires Mr. Yeats to use his best efforts to refinance the loan during the extension period.
RESOURCE IMPACT
The amendment extends for up to one year the repayment of the approximately $707,000 balance on the City loan and will result in a 1.50% increase in interest revenue on the loan for the first six months and a rate of at least 1% above the then market rate.

POLICY IMPLICATIONS
Given the recent significant downturn in the housing and credit markets, extending the term of the loan will allow some time for credit markets to stabilize and improve.

ENVIRONMENTAL REVIEW
This project does not constitute a project under the California Environmental Quality Act.

PREPARED BY: JAMES KEENE

CITY MANAGER APPROVAL: JAMES KEENE
City Manager

ATTACHMENTS
Attachment A: Amendment to Employment Agreement
Attachment B: November 21, 2008 Letter from Carl Yeats