

# TRANSMITTAL

To:

**THE COUNCIL**

Date: 01/19/2016

From:

**THE MAYOR**

**TRANSMITTED FOR YOUR CONSIDERATION. PLEASE SEE ATTACHED.**



(Ana Guerrero)

**ERIC GARCETTI**  
Mayor



Los Angeles  
**HOUSING+COMMUNITY**  
Investment Department  
Housing Development Bureau  
1200 West 7th Street, Los Angeles, CA 90017  
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hcidla.lacity.org



Eric Garcetti, Mayor  
Rushmore D. Cervantes, General Manager

January 15, 2016

Council File: 15-0132  
Council District: Citywide  
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The Honorable Eric Garcetti  
Mayor, City of Los Angeles  
Room 300, City Hall  
200 North Spring Street  
Los Angeles, CA 90012

Attention: Mandy Morales  
Legislative Coordinator

**COUNCIL TRANSMITTAL: PROPOSED LOS ANGELES HOUSING AND COMMUNITY INVESTMENT DEPARTMENT (HCIDLA) RECAPITALIZATION POLICY OF AFFORDABLE HOUSING DEVELOPMENTS WITH EXISTING HCIDLA AND/OR COMMUNITY REDEVELOPMENT AGENCY- LOS ANGELES (CRA/LA) LOANS**

**SUMMARY**

The General Manager of the Los Angeles Housing + Community Investment Department (HCIDLA) respectfully submits this transmittal for Mayor and City Council review and consideration. Through this transmittal, HCIDLA seeks the approval to adopt the attached Recapitalization Policy for affordable housing developments with existing HCIDLA and/or CRA/LA debt.

**RECOMMENDATIONS**

The General Manager, of the HCIDLA, respectfully recommends:

1. That your office schedule this transmittal at the next available meeting(s) of the appropriate City Council committee(s) and forward it to the City Council for consideration and approval immediately thereafter;
2. That the City Council, subject to the approval of the Mayor, direct the General Manager of HCIDLA to adopt the proposed Recapitalization Policy and incorporate it as Attachment 1 to the Bond Program Policies; and
3. The Mayor concur with the action of the City Council.

## **BACKGROUND**

In 1986, the Tax Reform Act created what we know today as the Low Income Housing Tax Credit (LIHTC) program. Governed under the Internal Revenue Service's (IRS) Section 42 and administered by state issuing agencies through their Qualified Allocation Plans (QAP), LIHTC projects are awarded Federal tax credits which may be used to generate equity investments in affordable housing projects. The LIHTC awards equal the value of tax credits taken over a 10 year period, and must be used to provide affordable housing for a minimum period of 15 years. Due to the competitive nature of the tax credit award process, developers of LIHTC projects usually agree to place affordability restrictions that surpass the required 15-year tax credit compliance period. In California, the local and state agencies require 55-year covenant restrictions on LIHTC affordable housing projects.

During the 15-year tax credit compliance period, LIHTC housing developments are subject to IRS recapture of some or all of the value of the credits. Therefore limited partners who purchase the tax credits often remain in the ownership structure until the tax credit compliance period comes to an end. After that, limited partners may exit the partnership by selling or transferring their interest to an entity related to the general partner. At that time, the new owner is eligible to reapply for tax credit capital and many projects use this opportunity to refinance and upgrade the property.

LIHTC projects usually seek to recapitalize tax credits before the 55-year affordability term is over. As a consequence, very few tax credit projects are at risk of converting to market rate housing. Rather, the recapitalization is a financing event that enables a property owner to upgrade the housing and restructure outstanding debt. And since many of the LIHTC properties also carry City sponsored debt, LIHTC recapitalization provides the developer and the City an opportunity to review the performance of the housing, make necessary repairs and upgrades, pay off debts, and renegotiate the deal structure based on current project requirements.

## **PURPOSE OF THE PROPOSED RECAPITALIZATION POLICY**

HCIDLA recommends a Recapitalization Policy to establish clear administrative procedures and a framework for making sound financial decisions with public funds. HCIDLA believes the Recapitalization Policy will serve to strengthen the capacity of the City's affordable housing providers to create, preserve and maintain affordable housing in the City of Los Angeles. The primary objectives of the HCIDLA Recapitalization Policy are to:

- Rehabilitate the City's Affordable Housing Stock
- Preserve the Supply of Existing Affordable Housing
- Improve the Financial & Managerial Performance of Projects
- Enhance the Long-term Energy and Resource Sustainability Profile of the Projects
- Improve Disabled Access to Affordable Housing

While pursuing the above public objectives, HCIDLA recognizes that it is responsible for protecting Federal and lender interests by following generally accepted underwriting and lending practices for public loan programs based on sound judgment. Toward this end, after achieving the public objectives stated above, HCIDLA will seek repayment of outstanding public debt when feasible, including outstanding principal and accrued interest. Any loan repayments will be recirculated into the Affordable Housing Trust Fund to be reinvested in new affordable housing units.

## **RECAPITALIZATION POLICY DEVELOPMENT**

HCIDLA has been working on the development of a Recapitalization Policy for several years and has incorporated the feedback received from stakeholders during several public meetings, the review of an independent third party consultant hired by the Office of the City Administrative Officer's Debt Management Group, and the Southern California Association of Non Profit Housing (SCANPH). The SCANPH developers were primarily concerned that the City recognize recapitalization events as important opportunities for non-profit affordable housing developers to stabilize and re-invest in the housing stock and to promote the long-term preservation of affordable housing as the chief priority of the Recapitalization Policy. HCIDLA believes the proposed Recapitalization Policy addresses these concerns, as well as our fiduciary responsibility as a lender of public funds, by defining the prudent lending practices that we must uphold.

## **SUMMARY OF KEY PROVISIONS**

Below is a summary of the key provisions of the Recapitalization Policy that created the greatest amount of discussion. The full Recapitalization Policy is attached.

### **§7a) Eligible Sponsor**

To provide adequate time for project financing to be evaluated prior to the California Debt Limit Allocation Committee (CDLAC) application deadline, a term sheet showing the Limited Partner exit plan must be submitted to HCIDLA at least 60 days before the CDLAC application deadline.

### **§7f) Energy Efficiency**

In an effort to reduce long term operational costs and contribute positively to the environment, projects are encouraged to improve the energy efficiency 20% above the modeled energy consumption of the current building(s) based on existing conditions. Modeling for improvements and baseline will follow the Tax Credit Allocation Committee (TCAC) regulations. Where possible, projects should leverage local utility rebates, state incentives and financing. Projects will be encouraged to track energy and water usage through approved benchmarking software, and incorporate a tenant data release form in their leases so that the building's utility usage can be tracked.

### **§7g) Use of Sales Proceeds**

Proceeds from the sale upon acceptable project financial structuring shall be used first to pay the balance on the first deed of trust. Any remaining cash proceeds shall be used for the physical needs of the property, and to pay down the HCIDLA loan principal and accrued interest balance. If the Project has more than one public loan, HCIDLA will refer to the original loan agreement as the guiding document for priority of payoffs. Payoffs will follow the lien position in the loan agreement.

### **§ 7l) Developer Fees**

Developer fees shall be paid consistent with the Affordable Housing Trust Fund (AHTF) Pipeline Regulations, Policies and Procedures.

**§8a) Fees**

The City will incur costs to process these Projects. Therefore, HCIDLA will charge a Construction & Financing Origination Fee of \$30,000 for the recapitalization transaction that involves restructuring public funds. This fee presumes a Bond/4% tax credit transaction and it is in addition to any other Bond Program transaction fee that may apply. Said fee is due to HCIDLA based on the following schedule:

**CONSTRUCTION & FINANCING ORIGINATION FEE SCHEDULE**

- a. 10% (i.e., \$3,000) due at the time of application.
- b. 35% (i.e., \$10,500) Loan Underwriting fee due at the time of escrow closing.
- c. 55% (i.e., \$16,500) Loan Document processing due at the time of escrow closing.

**§9b) Re-Casting HCIDLA's Loan Balances**

HCIDLA understands that a recapitalization transaction may require that HCIDLA, and the other public lenders, "re-cast" or re-lend to the purchasing entity a portion of its principal balance and/or accrued interest based on the purchase price established above. HCIDLA will base consideration for re-casting a portion of its principal balance and/or accrued interest on the economics of the transaction and the achievement of public benefits and policy objectives mentioned in Section 4. It should be noted that HCIDLA cannot re-allocate or earmark repayment funds to a specific future project. Any payments or partial pay downs of public funds result in funds returned to the City's Affordable Housing Trust Fund, which must then be awarded to new projects according to the AHTF guidelines.

**§10d) Accessibility Requirements for Multifamily Housing:**

The new owner will be responsible for meeting the accessibility requirements of the Fair Housing Act, Americans with Disabilities Act of 1990 (ADA), specifically Title II of the ADA, the Uniform Federal Accessibility Standards (UFAS), and Section 504 of the Rehabilitation Act of 1988, whichever is applicable. Projects shall submit a completed HCIDLA Accessibility Design Review (ADR) Form at the time of application. An accessibility certification from a Certified Access Specialist ("CASP") will be required at the end of construction. The ADR Form will identify the CASP chosen to complete the final certification.

**IMPLEMENTATION**

HCIDLA anticipates a rapid increase in the volume of recapitalization requests in 2016 due to the maturing of the LIHTC program. In anticipation of this, HCIDLA will work with the SCANPH to draft a mutually acceptable timeline for recapitalization negotiations that will ensure timely processing of refinancing requests. In addition, HCIDLA is in the process of developing strategies to increase the department's capacity for refinancing older projects while maintaining its focus on new housing construction financing. HCIDLA recognizes the importance of working in partnership with the Affordable Housing Developer Community to implement this new policy.

**FISCAL IMPACT**

There is no fiscal impact to the General Fund.

Prepared By:

  
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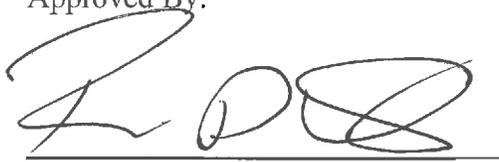
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General Manager



**THE CITY OF LOS ANGELES  
HOUSING AND COMMUNITY INVESTMENT DEPARTMENT (HCIDLA)**

**POLICIES FOR EVALUATING THE RECAPITALIZATION OF CERTAIN AFFORDABLE HOUSING  
DEVELOPMENTS WITH PRE-EXISTING FINANCING FROM HCIDLA.**

**1. INTRODUCTION**

This document outlines HCIDLA's policies ("HCIDLA Recapitalization Policy") guiding HCIDLA's review and evaluation of certain affordable housing developments with existing HCIDLA financing ("Existing Financing") that are proposed to be restructured pursuant to a new allocation of tax-exempt bonds and 4% low income housing tax credits *and* require certain discretionary approvals from HCIDLA with regard to the Existing Financing. For purposes of this policy, Existing Financing also includes financing originally provided by certain predecessor agencies now under the jurisdiction of HCIDLA (e.g., the Community Redevelopment Agency of the City of Los Angeles).

This HCIDLA Recapitalization Policy will allow HCIDLA to consistently evaluate proposed restructure requests for projects described herein that also require discretionary HCIDLA approvals for Existing Financing. The HCIDLA Recapitalization Policy is intended to enable developers of affordable housing and HCIDLA staff to determine amounts, if any, the City of Los Angeles (City) shall receive as repayment of the Existing Financing coincident with HCIDLA discretionary approvals. Amounts received shall be used by HCIDLA for further affordable housing purposes in the City.

This HCIDLA Recapitalization Policy shall be part of the Bond Program Policies and are incorporated therein by reference. Unless otherwise specifically noted, these policies shall not supersede or eliminate the applicability of any other relevant policy of the City or HCIDLA.

The General Manager of HCIDLA, Mayor and City Council may waive one or more aspects of the HCIDLA Recapitalization Policy if justified by the combined benefits to the City, the project, and the project sponsor. HCIDLA reserves the right to create and promulgate rules, requirements and regulations in order effectuate the purposes of this HCIDLA Recapitalization Policy.

**2. APPLICABILITY:**

HCIDLA Recapitalization Policy shall apply only to projects ("Projects"):

- a) With Existing Financing where the proposed refinance/restructure proposes to use the Low Income Housing Tax Credit program in combination with private activity tax-exempt bond financing; *and*
- b) Where any portion of the Existing Financing (including all principal and accrued interest and fees) is not repaid, in full, on or before the effective date of the proposed

refinance/restructure and therefore requires certain discretionary approvals from HCIDLA with regard to the Existing Financing.

Further, this HCIDLA Recapitalization Policy shall specifically not apply to projects where all outstanding obligations to HCIDLA are repaid, in full, on or before the effective date of the propose refinance/restructure.

### **3. INTENT**

The intent of the HCIDLA Recapitalization Policy is to enable the preservation and rehabilitation of the City's affordable housing stock and to ensure the prudent use of public funds to achieve those goals.

### **4. OBJECTIVES**

HCIDLA anticipates the application of the HCIDLA Recapitalization Policy will result in the adequate capitalization and stabilization of existing affordable housing developments within the City of Los Angeles, and serve to strengthen the capacity of the City's affordable housing providers to create, preserve and maintain affordable housing in the City of Los Angeles. The objectives of the HCIDLA Recapitalization Policy are outlined below.

#### **a) Rehabilitate the City's Affordable Housing Stock**

Improve the condition of affordable housing projects by providing for the appropriate levels of rehabilitation and correction of deferred maintenance items.

#### **b) Preserve the Supply of Existing Affordable Housing**

Preserve affordable housing through the extension of the time period of affordability covenants.

#### **c) Improve the Financial & Managerial Performance of Projects**

Reduce ongoing operating costs associated with deferred maintenance of projects and, when appropriate, to address the problems created by ineffective management.

#### **d) Enhance the Long-term Energy and Resource Sustainability Profile of the Projects**

Reduce energy and water consumption in affordable housing projects when possible. Toward this goal, projects should strive to achieve a 20% improvement in energy efficiency.

#### **e) Improve Disabled Access to Affordable Housing**

Improve disabled access to affordable housing when possible.

### **5. PRUDENT LENDING PRACTICES**

HCIDLA is responsible for following Prudent Lending Practices, which are defined as generally accepted underwriting and lending practices for public loan programs, based on sound judgment to protect Federal and lender interests. Prudent Lending Practices provide for compliance with local laws and maintenance of a security interest in loan collateral. Toward this end, after achieving the public objectives, HCIDLA will

seek repayment of outstanding public debt when feasible, including outstanding principal and accrued interest. Any loan repayments will be recirculated into the Affordable Housing Trust Fund to be reinvested in new affordable housing units.

## 6. BACKGROUND

HCIDLA provides supplemental financing to certain multifamily rental developments that contain units where occupancy is restricted to households with income equal to or less than a specific income level (for instance, 60% of the Area Median Income), and the rent payable by the families occupying the restricted unit is similarly restricted (for instance, to 30% or 60% of Area Median Income). The net income generated by the restricted units can support only a limited amount of conventional "first mortgage" financing, which supports only a limited portion of the costs of constructing or rehabilitating the development. Funding sources specifically created to assist in financing "affordable" developments supplement (or, in some cases, supplant) conventional first mortgage financing. These include public sources that may be loaned or granted to qualifying developments through Federal (e.g., HOME funds from the department of Housing and Urban Development), State (e.g., Multifamily Housing Program Funds from the California Department of Housing and Community Development), local (e.g., Affordable Housing Trust Fund from the City of Los Angeles Housing and Community Investment Department) agencies. These funds are typically of limited availability and are therefore allocated to projects on the basis of meeting the City's affordable housing priorities, achieving the greatest public benefit and highest leverage.

HCIDLA (and other public lenders) generally provide this supplemental financing in the form of a subordinate loan (i.e., subordinate in rights and remedies to senior, first mortgage financing provided by private institutions, including first mortgage financing funded with the proceeds of tax-exempt bonds). The subordinate loan is secured by a deed of trust subordinate to the first mortgage lender's deed of trust, and is generally payable only to the extent of cash available (also known as "residual receipts") after payment of all other project expenses and first mortgage debt service. In addition to the loan and other related real estate documents, the project must adhere to certain regulatory restrictions (e.g., number units subject to specific affordability restrictions, etc.). These regulatory restrictions are generally documented in a Regulatory Agreement recorded with the other loan documents.

These HCIDLA loans provide certain rights in connection with certain changes in the project, including transfer of project ownership, or sale or refinancing of the project. HCIDLA's rights would typically include the right of full repayment upon refinance, or the right to approve aspects of a refinance or restructure if all or a portion of HCIDLA's loans were to remain outstanding after the refinance or restructure.

In addition to first mortgages and Federal, State and local loan and grant funds, many affordable housing developments use the Low Income Housing Tax Credit program as an additional component of financing development costs. In general, investors contribute equity, which helps to pay development costs, in exchange for the ability to use the Low Income Housing Tax Credits.

The investors then become a part of the ownership, usually as a limited partner in the partnership that owns the affordable housing development.

The Tax Reform Act of 1986 created what we know today as the Low Income Housing Tax Credit (LIHTC) program. Governed under the Internal Revenue Service (IRS) Code's Section 42 and administered by State issuing agencies through their Qualified Allocation Plans (QAP) and adopted regulations, LIHTC projects are awarded ten years of federal tax credits. In exchange, LIHTC projects must be kept affordable for a minimum period of 15 years (the Tax Credit Compliance Period), but often the state issuing agencies and complementary local agencies apply much longer affordability restrictions than are required under the IRS regulations. Currently, in California, developers typically are required to accept a 55-year affordability restriction to be eligible for tax credit and private activity bond financing.

#### *Tax Credit Compliance Period*

While the tax credits flow for 10 years, the IRS requires a 15-year compliance period to enable the recapture of some or all of the tax credit value in the event a project is found to be non-compliant. Therefore, in order to safeguard their investment, Tax Credit Investors often remain a part of the limited partnership after their tax credits expire, until the completion of the 15 year Tax Credit compliance period. Typically, limited partners exit the investment after year 15 by selling their interests in the property to the general partner (GP) (or its affiliate or subsidiary) and the GP continues to own and operate the property.

#### *Extended Use Agreements*

Beginning in 1990 Federal law required tax credit projects to remain affordable for the 15-year initial compliance period plus a subsequent 15-year extended-use period. In California, most projects that received a Tax Credit Allocation after 1990 are subject to affordability restrictions of 30 to 40 years past the initial 15 year period. These extended use agreements may be imposed by the California Tax Credit Allocation Committee (TCAC) as well as by the local agency, such as HCIDLA, that provided a part of the financing for the development of the original project. As a result, many projects that have completed their 15 year Tax Credit Compliance Period are eligible for recapitalization using a new tax credit syndication, but are unlikely to be at risk of losing affordability.

#### *New Tax Credits*

When the 15-year Federal Tax Credit Compliance Period ends, the project is eligible for new acquisition as well as rehabilitation tax credits if syndicated with tax exempt private activity bonds. However, affordability restrictions are usually not at risk of being lost. **HCIDLA's key policy objective is to determine that the equity raised from the new allocation of LIHTC, in combination with the other newly available sources, are sufficient to improve and maintain the physical asset, and if sufficient resources exist, to repay all or a portion of the HCIDLA subordinate financing once the goals of the project preservation are achieved. This document contains policies that guide staff and allocate resources pertaining to the syndication of existing affordable housing projects financed with new 4% LIHTC together with private activity bonds.** To that end, this document contains Administrative Policies to provide procedural direction to

HCIDLA staff and Underwriting Policies to guide the public in their requests for HCIDLA cooperation and support.

## **7. UNDERWRITING REQUIREMENTS**

### **a) Eligible Sponsor**

To provide adequate time for project financing to be evaluated prior to the California Debt Limit Allocation Committee (CDLAC) application deadline, a term sheet showing the Limited Partner exit plan must be submitted to HCIDLA at least 60 days before the CDLAC application deadline.

### **b) Extension of Affordability**

The term of the Project's longest existing affordability covenant shall be extended at least an additional 15 years, subject to tax limitations and other relevant underwriting criteria, and subject to the "true-debt" test.

### **c) Project Useful Life**

The proposed transaction must result in the extension of the useful life of the project by at least 15 years. Items included in the scope of rehabilitation must be of a nature that targets capital improvement items whose useful life is coming to an end. The level of proposed rehabilitation must be appropriate to the current conditions of the project and correct all major physical deficiencies.

### **d) Management Deficiencies**

HCIDLA desires to ensure affordable housing projects will remain financially viable and well maintained. Properties suffering from financial, managerial, community/social and/or physical distress will be evaluated before refinancing is considered. A comprehensive physical, financial and managerial assessment by a third party will be required, and a review of the ownership decision history will be examined. A new ownership structure may be required by HCIDLA, and/or ownership controls may be placed on the project to ensure improved management. All entities involved in the new proposed project shall adhere to the City's new business policies.

### **e) Financial Benefits**

HCIDLA expects that the Projects, as a result of the refinancing/restructuring, will have improved long-term financial and operational capacity.

### **f) Energy Efficiency**

In an effort to reduce long term operational costs and contribute positively to the environment, Projects are encouraged to improve the energy efficiency 20% above the modeled energy consumption of the current building(s) based on existing conditions. Modeling for improvements and baseline will follow TCAC regulations. Where possible, projects should leverage local utility rebates, State incentives and financing. Projects will be

encouraged to track energy and water usage through approved benchmarking software, and to incorporate a tenant data release form in their leases so that the building's utility usage can be tracked. Project management staff should be trained on operation and maintenance of energy and water efficiency, energy management planning, tenant education and engagement on reduced energy and water use. HCIDLA will provide information about how to access information on energy efficiency programs and opportunities supported by the City.

**g) Use of Sales Proceeds**

Proceeds from the sale upon acceptable project financial structuring shall be used first to pay the balance on the first deed of trust. Any remaining cash proceeds shall be used to pay down the HCIDLA loan principal and accrued interest balance. If the Project has more than one public loan, HCIDLA will refer to the original loan agreement as the guiding document for priority of payoffs. Payoffs will follow the lien position in the loan agreement.

In the absence of documentation in the loan agreement, HCIDLA will accept a pro-rated amount of the net proceeds. Said prorated amount shall be the same as that amount included in the HCIDLA documents regarding the proration of cash flow for residual receipts when other public lenders are part of the project's financing. The current owner is expected to negotiate this payoff arrangement with the other subordinate public lenders.

Finally, for purposes of paying down principal balances, any remaining balance on a Federal Home Loan Bank Affordable Housing Program (AHP) loan, usually in junior position to the 1<sup>st</sup> deed of trust, will not be eligible for a pay down. HCIDLA expects that the current owner will secure approval of the FHLB to forgive the loan. If the AHP loan cannot be forgiven by the sponsoring lender, the loan must be restructured to accommodate the new financing. Any remaining cash after payment of the public debt, if any, will follow the waterfall as established by the limited partnership agreement (if still existing) or other governing legal documentation (e.g., subordinate loan agreements). Any unpaid developer fee, asset management fees or property management fees may be paid out of capital sources prior to payment of the HCIDLA and CRA loans. Any remaining GP or sponsor loan and or liabilities may be paid after the HCIDLA and CRA loans are paid.

**h) Purchase Price**

Transactions will be asked to maximize the purchase price from the sale of the Project to a new ownership partnership. HCIDLA expects the developer to work with their tax professional to prevent, or at worst minimize, write-offs of HCIDLA/CRA debt. Subject to prudent appraising practices, reasonable assumptions shall be made for Project Based Section 8.

**i) Appraisal**

HCIDLA will require submittal of an "as is" appraisal prepared not more than 120 days before or after the date of the purchase agreement or transfer of ownership. The appraisal must be prepared by a California State Certified General Appraiser having no identity of interest with

the development's partner(s) or intended partner or general contractor. In addition, the appraisal may not determine property value based solely on sales comparables of properties financed by public agencies. If a residential income approach is not utilized, applicant may submit either a separated market study completed within the last 6 months. Additionally, if the subject site is being sold by an entity related to the newly proposed ownership entity, any mark-up on the land costs must be clearly stated and will be subject to HCIDLA approval. HCIDLA will follow TCAC regulations for the timing of required appraisals and appraisal updates.

**j) Exit Taxes**

Exit taxes will be considered an allowable expense of the recapitalization transaction payable from sales proceeds. Exit terms sheets including exit tax costs are required to be provided to HCIDLA 60 days prior to the CDLAC application.

**k) Net Operating Income During Construction**

Recapitalization transactions involve tenant-occupied properties. HCIDLA will require that 75% of Net Operating Income (NOI) be included as a capital source. An analysis of how the amount included in the capital sources was derived must be submitted to HCIDLA.

**l) Developer Fees**

Developer fees shall be paid consistent with the Affordable Housing Trust Fund Pipeline Regulations, Policies and Procedures.

**m) Reserves**

Consistent with existing HCIDLA loan documents, the current owner is responsible for accumulating Replacement, Operating and/or Transition Reserves ("Reserves") and collecting Security Deposits. Any proposed reserves are to be disbursed upon approval of the lenders, including HCIDLA. Any proposed reserves shall be consistent with other lenders guidelines. Security Deposits are released to the tenants upon their exit of the property. However, both the Reserves and Security Deposits accounts will have balances at the time of sale. Those balances, in their entirety, will transfer over to the new owner. Neither the Security Deposits, nor the Reserves, can be used as a capital source to purchase the property. HCIDLA will require language in the Purchase and Sale Agreement that clearly specifies that all Reserve balances and Security Deposits will transfer over to the new ownership.

i. Contribution To Operating Reserves

For Operating Reserves, HCIDLA will allow the minimum Operating Reserve required by CDLAC, TCAC, senior lenders, the tax credit investor, or other public lenders to be the maximum allowed by HCIDLA. Any funds left over from the "Reserves" transferred to the new ownership, after depositing the Replacement and Operating amounts as set forth herein, shall be used for project related costs.

ii. Contribution To Replacement Reserves

Replacement Reserves will be funded, prior to distributions, at the rate consistent with CDLAC, TCAC, other lenders, the tax credit investor, public agencies and the physical needs assessment.

**n) Scope Of Rehabilitation**

HCIDLA will require a property needs assessment (PNA) or an engineering inspection report completed within the past twelve months by a qualified engineer or building inspector, to identify the remaining life of all major systems including, but not limited to, plumbing, electrical, HVAC, foundations and roof. Such reports shall include an accessibility report from a Certified Access Specialist (a "CASP" report), and an energy audit meeting the requirements of TCAC or other standard that may be specified by HCIDLA. The scope of rehabilitation will enable preservation of the asset for 15 years and as such may not include all of the elements that have been identified as deficient. Thus the scope of rehabilitation will address all "Immediate Needs" as identified in the PNA:

- i. All required accessibility elements as identified in the CASP report.
- ii. Certified compliance to Federal, State and local accessibility requirements.
- iii. All items necessary to meet the minimum construction requirements (including energy efficiency) of TCAC and CDLAC or other standards or requirements as may be required by HCIDLA to enable a 15 year life span of the facility.

**o) Project Costs**

HCIDLA will require a completed *proforma* in HCIDLA format at application. HCIDLA staff will review and analyze all costs, included but not limited to, property liability insurance. Said insurance usually includes some allowance for improvements. HCIDLA will analyze all costs to ensure that the proposed budget is not excessive.

**p) Operating Expenses**

Projects should generally use the underwriting guidelines referenced in the Affordable Housing Trust Fund regulations. Operating expenses shall mean actual, approved, reasonable and customary costs, fees and expenses directly attributable to the operation, recordkeeping, maintenance, taxes and management of the Project.

**q) Supportive Services**

A supportive services allowance will be allowed at the time of recapitalization based on the current HCIDLA authority as reflected in the Affordable Housing Trust Fund Program. If the provisions of the existing loan have a more favorable Supportive Services Policy than the current HCIDLA Supportive Services policy, the older loan terms may be carried into the new loan. However the current HCIDLA reporting requirement for social services must be implemented in all new loans.

**r) Contractor Requirements**

**i. LCP Tracker**

The selected contractor for the rehabilitation will be required to use LCP Tracker, or any other applicable software, to report payroll and affirmative action activity.

**ii. GMAX Contract**

The selected contractor for the rehabilitation will be required to use a GMAX contract. HCIDLA will use the TCAC standard to calculate maximum in overhead, general conditions and profit.

**iii. Construction Audit**

The owner will be required to include an audit of the construction contract as part of the cost certification. In addition to customary auditing protocols, the auditor must opine on the percentage of overhead, general conditions and profit collected by the general contractor, and any affiliated subcontractors and suppliers.

**8. ADMINISTRATION**

**a) Fees**

The City will incur costs to process these Projects. Therefore, HCIDLA will charge a Construction & Financing Origination Fee of \$30,000 for the recapitalization transaction that involves restructuring public funds. This fee presumes a Bond/4% tax credit transaction and it is in addition to any other Bond Program transaction fees that may apply. Said fee is due to HCIDLA based on the following schedule:

**CONSTRUCTION & FINANCING ORIGINATION FEE SCHEDULE**

- a. 10% (i.e., \$3,000) due at the time of application.
- b. 35% (i.e., \$10,500) Loan Underwriting fee due at the time of escrow closing.
- c. 55% (i.e., \$16,500) Loan Document processing due at the time of escrow closing.

**b) Roles And Responsibilities**

These transactions will be complicated and require multi-unit coordination (Administration, Bond, Occupancy and Portfolio Management).

**9. EXISTING HCIDLA FINANCING**

**a) Financing In Effect**

Nothing contained herein shall supersede the existing loan agreement for the Existing Financing. Existing Financing loan and program documents applicable to a project must have been executed, recorded and in all manner in full effect in order for a request for a proposed refinance/restructure to be considered and processed by HCIDLA pursuant to this policy.

**b) Re-Casting HCIDLA's Loan Balances**

HCIDLA understands that a recapitalization transaction may require that HCIDLA, and the other public lenders, "re-cast" or re-lend to the purchasing entity a portion of its principal balance and/or accrued interest based on the purchase price established above. HCIDLA will base consideration for re-casting a portion of its principal balance and/or accrued interest on the economics of the transaction and the achievement of public benefits and policy objectives mentioned in Section 4. It should be noted, HCIDLA cannot re-allocate or earmark repayment funds to a specific future project. Any payments or partial pay downs of public funds result in funds returned to the City's Affordable Housing Trust Fund, which must then be awarded to new projects according to the AHTF guidelines.

**c) Form of HCIDLA Loans**

HCIDLA and the City Attorney's Office will work with the new borrower's business and tax counsel to adopt a loan document form that best meets the needs of the transaction and the City. Moreover, where ever possible, HCIDLA will take the opportunity to combine all City loans (e.g. CRA, HOME, CDBG, Section 108, etc.) into one loan document.

**d) Revisions of HCIDLA's Business Terms:**

HCIDLA reserves the right to negotiate changes to the business terms in conjunction with the project sponsor during the financing process. Revision of business terms may include, but are not limited to, revising the annual payment structure, the interest rate, etc.

**e) Revisions to HCIDLA's Regulatory Terms**

Any recapitalization presents HCIDLA with the opportunity to revise and update its regulatory terms. Revision of regulatory terms may include, but are not limited to, bifurcating the covenants between HOME covenants and all-other HCIDLA covenants.

**f) Revisions to CRA Loans**

As the Housing Successor Agency to the CRA, HCIDLA will service and administer CRA loans in the same manner as HOME and CDBG loans during a recapitalization transaction.

**g) Write-Off of HCIDLA Loan Balances:**

HCIDLA recognizes that restructuring the public participation in a project may be required to achieve the public benefits for the City and the Project described in Section 4(a) and 4(b) of this policy. To this end, HCIDLA can write off a portion of the accrued interest on the City's loan if this approach achieves a clear and quantifiable public purpose, and only if the underlying economics support this approach. HCIDLA will not consider a transaction that inappropriately shifts financial losses to the City, and financial gains to other parties in the transaction.

HCIDLA expects the developer to work with their tax counsel to prevent, or at worst minimize any proposed write-off of HCIDLA loan interest. However, while HCIDLA will consider restructuring and/or relending (e.g., receiving a loan repayment that is subsequently re-loaned to the borrower) to the purchasing entity all, or a portion of, the original loan balance, including accrued interest, to support the purchase side of the transaction.

**h) Sharing Residual Receipts With Other Public Lenders**

Fifty percent of residual receipts shall be used to pay all public lenders, including HCIDLA, in proportion to their principal participation. The remaining 50% of residual receipts shall be paid to the project sponsor. The Buyer/Borrower is expected to negotiate this detail with the other public lenders. Finally, for purposes of residual receipts payments, any payments due on a Federal Home Loan Bank Affordable AHP loan, in junior position to the 1<sup>st</sup> deed of trust, will not be eligible for residual receipts payments. HCIDLA expects that the Buyer/Borrower will secure approval of the FHLB of this business term.

**i) Subordination**

HCIDLA may, at its sole discretion, subordinate security position and affordability covenants to a new conventional lender and/ or public agency lender. Subordination guidelines will be consistent with established practices under the AHTF regulations. If other public lenders outline specific subordination requirements, HCIDLA will cooperate with the other public lenders.

**10. RELATED PROGRAM REQUIREMENTS**

**a) HOME Program Requirements**

Projects for which HOME requirements apply, which have not met the original minimum HUD HOME Regulatory term, must meet and apply all HOME requirements, such as but not limited to, Relocation, Affirmative Marketing, Labor, Lead-Based Paint, Conflict of Interest, ADA, and Fair Housing as applicable.

**b) Uniform Relocation Act (URA)**

If applicable based on Federal funding, these transactions are to be handled as acquisitions. URA requires issuance of a voluntary acquisition letter and documentation of proof of receipt. HCIDLA will collect the appraisal to confirm that the “fair market value” presented in the voluntary acquisition letter is based upon a third-party analysis. In addition, HCIDLA will collect the purchase agreement to confirm that the amount paid for the property correlates to the amount in the voluntary acquisition letter.

**c) RSO Consistency**

The new owner will be required to abide by any applicable Rent Stabilization Ordinance (RSO) requirements.

**d) Accessibility Requirements for Multifamily Housing**

The new owner will be responsible for meeting the accessibility requirements of the Fair Housing Act, Americans with Disabilities Act of 1990 (ADA), specifically Title II of the ADA, the Uniform Federal Accessibility Standards (UFAS), and, Section 504 of the Rehabilitation Act of 1988, whichever is applicable. Projects shall submit a completed HCIDLA Accessibility Design Review (ADR) Form at the time of application. An accessibility certification from a Certified Access Specialist ("CASP") will be required at the end of construction. The ADR Form will identify the CASP chosen to complete the final certification.

## **11. CONFLICTS**

Some of the business and legal requests and proposed changes may be in conflict with current HCIDLA Portfolio Management policies. HCIDLA staff will identify those conflicts, and if it determines that the proposed transaction with its business and legal changes is a compellingly better transaction than the existing transaction, it will request authority to bypass established Portfolio Management policy. At some point in the future, once a few projects have been processed, HCIDLA may elect to submit these changes for the establishment of programmatic approval, along with program-specific underwriting policies.