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April 12, 2024

Council File:	21-0600-S101	
Council Districts:	CD1	
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Honorable Members of the City Council
City of Los Angeles
c/o City Clerk, City Hall
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Los Angeles, CA 90012

COUNCIL TRANSMITTAL: RECOMMENDATIONS FROM THE LOS ANGELES HOUSING DEPARTMENT (LAHD) REGARDING ACQUISITION ANALYSIS OF HILLSIDE VILLA APARTMENTS AND EXECUTION OF A NEW COVENANT AGREEMENT

SUMMARY

Hillside Villa Apartments is a 124-unit apartment building constructed in 1989 with funds from the Community Redevelopment Agency of the City of Los Angeles and the City of Los Angeles, and a 30-year covenant restricting the units to affordable rents. As the covenants expired in 2019 and notices were given to the tenants and the City, the council office and tenant leaders began searching for ways to preserve affordability for a longer period. At the September 13, 2021 City Council Budget and Finance Committee meeting, LAHD was directed to determine if there were funding sources to acquire, possess, and transfer the Hillside Villa Apartments property to a new owner that would maintain affordability. In response to this Council action, LAHD released a report on May 9, 2022 (C.F. 21-0600-S101) seeking Council authorization to expend funds to conduct due diligence studies including commissioning an appraisal, environmental study, and physical needs assessment to inform a financial feasibility study, to make a conditional offer to purchase at a price not to exceed the appraised amount, and return to Council with an analysis that would demonstrate that the acquisition, rehabilitation and operations of the property by a new buyer would be feasible with funding from LAHD with terms and conditions similar to those set forth in the Affordable Housing Managed Pipeline guidelines.

On May 27, 2022, Council adopted the LAHD recommendations. The Department subsequently entered into a Professional Services Agreement (PSA) with HACLA to conduct and pay for due diligence activities. HACLA made several unsuccessful attempts, as did LAHD, to secure an agreement from the property owner to access the property for purposes of the appraisal and related studies. In November 2022 the City Attorney petitioned for a court order authorizing a pre-acquisition property inspection. On January 26, 2024 the Owner and City agreed that the City could enter the property for purposes of an updated appraisal. The appraisal results are discussed below.

The property owner has maintained throughout the process that he will not willingly sell the property. The site is developed with 124 units but is zoned for more than twice that number. Even with the requirement to replace all the affordable units and provide a right of return, the owner believes the redevelopment of the site to provide more housing is an opportunity to keep open for the future when this building ages. The purchase of the property from an unwilling owner would be a long, expensive and legally uncertain process, resulting in much higher acquisition costs. In lieu of a purchase and sale agreement, LAHD and the owner have negotiated a new covenant agreement that extends the affordable rent term for 15 years and 2 months, provides a longer repayment term for tenants that owe back rent for the period between 2019 and 2024, and gives the City a first right of refusal to purchase the site if the owner decides to sell any time before February 2037. Additional details are provided below.

RECOMMENDATIONS

I. That the City Council, subject to the approval of the Mayor:

   A. Authorize the General Manager of the Los Angeles Housing Department ("LAHD"), the City Attorney, or their designees, to execute the following agreements in substantial conformance with the terms described herein:

      1. Authorize LAHD to enter into a new affordability covenant with Owner in substantial conformance with the terms described herein, and instruct the City Attorney to draft the covenants and any necessary documents to effectuate such agreement, in exchange for a payment not to exceed $14,950,000.

      2. Authorize LAHD to negotiate to enter into, and the City Attorney to prepare, an amendment to the Participation and Loan Agreement, and a new Agreement Containing Covenants Affecting Real Property and any other necessary documents in connection thereto including:

         a. Retroactively reinstate and extend the term of HDG Loan CRA871015-003 ($1,860,000 Housing Development Grant Program loan) with 636 NHP, LLC from the original end date of March 1, 2024 to a new end date of February 28, 2034. Amend loan to a 0% interest forgivable Service Payback Loan forgivable in annual increments;

         b. Retroactively reinstate and extend the term of CRA Loan CRA871015-004 ($3,585,300 CRA/LA loan) with 636 NHP, LLC from the original end date of March

1, 2024 to a new end date of February 28, 2034. Amend loan to a 1% simple interest loan with a payment due annually, and a balloon payment of principal at the end of the term;

3. Authorize LAHD to draw a demand warrant from the Linkage Fee Fund 59T, payable to Owner or its designee as directed, in amount not to exceed $14,950,000.

4. Authorize LAHD, the City Attorney, or their designees to make necessary technical adjustments, subject to the approval of the City Administrative Officer and authorize the Controller to implement the instructions.

B. Authorize the General Manager of LAHD, or designee to obligate and expend Affordable Housing Linkage Fee (AHLF) funds to pay the Covenant Fee to the Owner as follows:

Project Name	Fund No.	Account	Amount
Hillside Villa Apartments	59T	43S724 – Rental Preservation	$6,976,007
Hillside Villa Apartments	59T	43W724 – Rental Preservation	$4,857,253
Hillside Villa Apartments	59T	43Y724 – Rental Preservation	$3,116,740
		Total:	$14,950,000

C. AUTHORIZE the General Manager of LAHD, or designee, to prepare Controller's Instructions and any necessary technical adjustments consistent with Mayor and City Council actions, subject to the approval of the City Administrative Officer (CAO), and instruct the Controller to implement the instructions.

BACKGROUND

The Hillside Villa Apartments, located at 636 North Hill Place, Los Angeles, CA 90012, houses low-income tenants facing displacement due to expired affordability covenants. Of the 123 tenants currently housed in the building, 68 have Section 8 rental vouchers and are able to pay the uncovenanted rents, and 38 low income households do not have Section 8 vouchers. The remaining 18 units consist of 17 market rate units and 1 manager's unit.

On January 31, 2020, Councilmember Cedillo filed a motion (C.F. No. 20-0148) to explore using eminent domain to acquire properties with expiring covenants, including Hillside Villa Apartments. On March 27, 2020, an amending motion was filed, which instructed LAHD, with the assistance of the City Attorney, to report back on recommendations for the acquisition of Hillside Villa Apartments through the use of eminent domain to preserve affordable housing for public use. On July 1, 2020, Council took action to approve the report back. Although the City Attorney at the time opined that the use of eminent domain may be possible, LAHD and the CAO were unable to identify feasible funding sources to purchase a building at significantly over-appraised value, as is typically necessary in most eminent domain cases. The City Administrative Officer was asked to report on the potential use of Coronavirus Relief Act funds, but the extended time for an eminent domain purchase was not consistent with the COVID fund requirements. LAHD considered the use of a Section 108 loan but HUD regulations prohibit the use of those funds for eminent domain. The Council was asked to consider a General Fund Reserve loan, which resulted in Council directing LAHD to determine the pathways to repayment of such a loan.

In May 2022, Council acted on LAHD recommendations to authorize LAHD, with assistance from HACLA, to conduct due diligence activities including commissioning an appraisal, environmental hazards study, and physical needs assessment to inform the feasibility analysis of purchasing, rehabilitating and financing a loan for the preservation of Hillside Villa Apartments. LAHD was instructed to determine if the preservation project was feasible within the department's Affordable Housing Managed Pipeline guidelines, and to return to the Council and Mayor with recommendations regarding next steps.

Status of Due Diligence Work

The Department subsequently entered into a Professional Services Agreement (PSA) with HACLA to conduct due diligence activities. HACLA made several attempts, as did LAHD staff, to secure permission from the property owner to access the property for purposes of the appraisal and related studies, but the owner refused. In November 2022 the City Attorney petitioned for a court order authorizing a pre-authorization property inspection. On January 26, 2024 the Owner and City agreed that the City could enter the property for purposes of an updated appraisal. A 2024 appraisal has been subsequently obtained, positing a Hypothetical Market Value Upon Stabilization of $44,875,000, or $361,895 per unit.

Recently, during a special Systematic Code Enforcement Program (SCEP) inspection performed to verify compliance with state health and safety codes and local building regulations, there was an average of only one violation per unit, which is fewer than typical buildings, with no major violations. Based on the findings, it was determined that the building appears to be well maintained.

Purchase Scenarios

LAHD has reviewed various financing options. Keyser Marston Associates, Inc. (KMA) was engaged to model various potential long-term financing scenarios considering affordability, projected rehabilitation costs, eligible funding sources, and other costs.

Based on these financing scenarios, including assumptions for the acquisition settlement, rehabilitation and other project costs adjusted for current interest rates and construction costs, the City has updated the financing scenario and has assumed the final total costs of acquisition, rehabilitation and refinancing would be almost $93 million, or $748,665 per unit. Additionally, LAHD has projected an increase in costs based on today's interest rates and insurance costs, and determined that the project would require approximately $51.3 million in subsidy. For details see Attachment A: Financing Scenario.

Although LAHD and HACLA were not able to conduct all of the due diligence studies needed for detailed analyses, the informed estimate was based on a recent 2024 appraisal, the experience of other government agencies with use of eminent domain, and the rehabilitation needs for buildings of this age. LAHD has prepared estimated project costs and identified potential funding sources, and has determined that the acquisition of the property from an unwilling owner was not financially feasible within LAHD's program guidelines.

Current LAHD preservation program guidelines as approved by the City Council and Mayor established a maximum loan amount of $14 million and $140,000 per unit. Based on the amount of subsidy and owner's lack of interest in a voluntary sale, the City has negotiated a covenant extension with the owner as noted below.

Covenant and Loan Extension Terms

1. PAYMENT TERMS: The Project is currently subject to a Participation and Loan Agreement between former CRA and the Owner, dated March 13, 1986. The affordability covenants in that Agreement expired at the end of 2018. To extend those affordability covenants for fifteen years and two months the City will pay the Owner a one-time fee of $14,950,000 (the "Covenant Fee") upon execution of new affordability covenants and the amendment and extension of the existing City loans (the "Covenant Agreement"), based on the present value of additional years of affordable rents following expiration of the original affordability covenants, with such new covenants commencing on January 1, 2019 through February 28, 2034. The Covenant Fee has been calculated as the difference between the market rents and the affordable rents during the covenant period, adjusted for growth and the net present value of the payment. COVID-19 Emergency Rental Assistance Payments made in excess of covenanted rents, as provided by the Owner's representative, have been deducted from the Covenant Fee as well as a deduction of the difference between the HDG loan conversion and the claim filed by the owner against the City.

2. COVENANT PERIODS: There are five categories of units with different covenanted rents and covenant periods:
   a) 38 units with expired rental restrictions that were previously covenanted as very low-income units and that do not have Section 8 vouchers that will have new covenants starting January 1, 2019 and ending February 28, 2034.
   b) 34 units with affordability covenants under the CalHFA agreement ending March 2024 and that also have tenants with Section 8 vouchers will be covenanted to continue to rent to Section 8 voucher holders at the current voucher payment standard, with an effective date of March 1, 2024 and an ending date of February 28, 2034.
   c) 33 Section 8 units without covenants with Section 8 vouchers will be covenanted to continue to rent to Section 8 voucher holders at the current voucher payment standard from the effective date of this Agreement to an ending date of February 28, 2034.
   d) 17 units that are not occupied by lower income residents will not be covenanted and will continue to be rented at market rents.
   e) 1 unit occupied by a resident manager is not covenanted.

3. RESTRICTED UNITS: The initial covenants restricted affordability to households earning below 50% of area median income and 120% of area median income. In total, the new covenants will require that at least 36 units shall be designated as very low-income units affordable to households earning less than 50% of the area median income ("AMI") and 70 units shall be designated as moderate-income units affordable to households earning less than 120% of AMI (collectively, "Restricted Units"). Thirty-eight of the Restricted Units are rented to low and very low-income households with legacy rents that differ

from rents that would be charged to new eligible tenants. The Covenant Fee calculations include these legacy rents. The legacy rents, with eligible increases as approved in the HCD Rent Schedule published by the Los Angeles Housing Department periodically, shall be the Restricted Rents for the Restricted Units, until a vacancy occurs. Upon vacancy, the mix of Restricted Units may change over time provided that the total number of very low-income units is 36 or more. A moderate-income unit may also be occupied by a very low income or low-income household at an affordable very low or low-income rent, but the total number of very low or low-income designated units may not decrease. All Restricted Units shall be designated as “floating” covenanted units. When units are “floating,” the specific dwelling units designated as Restricted Units may change over time as units are vacated, provided the total number of Restricted Units remains at least 106. Each substituted unit must be comparable in terms of size, features, and number of bedrooms to the original Restricted Unit.

4. INCOME CERTIFICATION FOR RESTRICTED UNITS: Income certification for initial eligibility will be required of all Restricted Units, except for tenant households that have already been certified as eligible in the prior covenant period or that have been certified as eligible by the Housing Authority of the City of Los Angeles for issuance of a rental voucher and has provided a Housing Assistance Payment Contract to the Owner and Tenant. Re-certification will not be required thereafter unless the resident moves to another unit. If tenants at initial certification have higher incomes than designated for the unit occupied, but are eligible for a unit with a higher limit, the owner shall re-designate the occupied unit as a higher income unit and rent the next available unit to an eligible household at the lower income limit, so that there is continued compliance with the Restricted Units mix.

5. CONVERSION OF CITY LOANS: There is a $3,585,300 interest free loan from the Community Redevelopment Agency of the City of Los Angeles that matures on March 1, 2024, and a $1,860,000 interest free loan from the City of Los Angeles that also matures on March 1, 2024. These loans will be extended at the same terms until February 28, 2034 so that they mature on the same date that the covenant agreement expires. The CRA loan will be amended to a 1% simple interest loan with a payment due annually. The HDG loan will be amended to a 0% interest forgivable Service Payback Loan forgivable in annual increments. All other provisions in the CRA and City loan agreements and covenant agreements will remain in full force and effect except that the provisions limiting the rent and incomes of renters shall be replaced by the provisions of the Agreement and shall govern the rent and income limits.

6. INCREASE IN LOAN BALANCES UPON NOTICE OF DEFAULT THAT IS NOT CURED: In the event that the Owner defaults on any provision of the Agreement, such an event shall be considered an event of default under the Promissory Note, Deed of Trust, and the Agreement. In the event of a default that is not cured and a resulting foreclosure, the balance of the CRA loan shall be increased by the amount of the Covenant Fee reduced by one tenth for every year that the Agreement was in effect and was not in default.

7. USE OF SECTION 8 RENTAL VOUCHERS: City and Owner agree that consistent with California law Owner may rent to any income eligible tenant regardless of source of rental payment, including Section 8 rental vouchers.

8. EXTENDED REPAYMENT PERIOD FOR COVID-RELATED DEBT. In order to avoid displacement, Owner has agreed to offer any eligible households with household income as extremely low, very low-, low-, or moderate-income levels, the opportunity to repay rent debt owed from the period between January 1, 2019 to the effective date of this Agreement over even monthly payments for a period of six years. Owner shall offer this extended payment plan to each eligible household, and if the household enters into a payment agreement with interest not to exceed 3% simple annual interest, and makes payments as required, Owner will not seek to evict tenants for unpaid rent covered by that agreement. In the event that a tenant pays less than the sum of the affordable rent and the back rent payment amount in any month, any amount paid shall be credited first to the back rent payment and second to the Affordable Rent. The limits on Affordable Rents set forth in this Agreement shall not apply to the agreed-upon monthly back rent payments in the Owner and Tenant repayment agreement. The City shall not be a party to the payment plan agreements between Owner and tenants.

9. RENT INCREASES: Not more than once per year, Owner may adjust the rents for Restricted Units after the first anniversary of the date the Lower Income Household began occupying the Restricted Unit. For Restricted Units, that amount may not exceed the HCD rents based on the annual adjustments in the income limits for HCD Lower Income Households in Los Angeles County.

10. ACCESSORY DWELLING UNITS: The Owner represents that he has secured entitlements and building permits to add eighteen accessory dwelling units to the property in the parking structure as permitted by California law. These additional units will not be subject to restricted rents or to the Covenant Agreement.

11. COVENANT FEE: The Covenant Fee shall be paid as a one-time payment to the Owner and shall be funded, at the City's sole discretion, using the following sources of funding:

Funding Source	Amount
Linkage Fee Fund 59T	$14,950,000
Total Fee Amount	$14,950,000

12. PROPERTY OWNER IDENTITY AND PROPERTY DESCRIPTION: The Owner is 636 NHP LLC, a California limited liability company, whose managing member is Thomas Botz, an individual. The Owner owns a fee interest in the Property. The Covenant Agreement shall be recorded against the property and shall be binding on successors for the term of the Agreement.

13. MUTUAL RELEASE OF ALL CLAIMS: Upon execution and approval of the Agreement, the City and Owner will release all claims against each other relating to the above-entitled matter.

14. RIGHT OF FIRST REFUSAL: City has right of first refusal if the Project is offered for sale or contracted for sale to a bona fide third-party purchaser before the covenant expiration date, February 28, 2034, plus 3 years. City will have the right to buy the Project at terms substantially similar to those offered by the third party, in which event, the Owner shall sell the Project to the City.

15. PARKING AND STORAGE: The provision of parking or storage is not required to be part of the package offered to the tenant for affordable rents, although, if provided, these facilities and areas must be made available on a comparable basis to all tenants in the building.

LAHD CONCLUSION AND RECOMMENDATIONS

The Owner is unwilling to sell and would like to preserve his right to sell in the future because of potential opportunities to redevelop the property. The City's investment to extend the terms of affordability was the result of challenging negotiations. Ultimately, a deal was reached that ensures tenants can maintain affordable rents for at a total of 15 years, at a cost of $141,000 per unit, which is slightly over the $140,000 City subsidy limit in the newly adopted Preservation Program Guidelines. To streamline the preservation approach using covenant extensions. LAHD plans to present Council with comprehensive guidelines covering subsidy limits, extension terms, income eligibility and other key terms to support residents in buildings with restrictions that have expired using a more adaptable and replicable approach.

The financial feasibility analysis does not find that the acquisition and rehabilitation of the property is feasible within guidelines. Based on current interest rates and operating costs cost, as well as additional rehabilitation cost increases, the City has assumed the final total development cost if this project were purchased through eminent domain would be approximately $800,000 per unit, which is not feasible and is outside of program guidelines. As an alternative to avoid tenant displacement, staff has negotiated new covenant term and loan extensions with the owner, and recommends that the Council and Mayor authorize LAHD and the City Attorney to negotiate and execute the final documents as described above.

FISCAL IMPACT

There is no impact to the General Fund.

Approved By:

Ann Sewill

ANN SEWILL
General Manager
Los Angeles Housing Department

ATTACHMENTS:

Attachment A – Financing Scenario

Attachment A: Financing Scenario

I. ACQUISITION COSTS [1]					
City Purchase Price	124	Units	$544,355	/Unit	**$67,500,000**
City Acquisition Legal Costs		Allowance			$500,000
City Holding Costs		Allowance	18	Months	$0
Closing Costs	1.00%	of Acq Costs			$675,000
TOTAL ACQUISITION COSTS	124	Units	$553,831	/Unit	**$68,675,000**
II. RELOCATION COSTS [2]					
Permanent Relocation Costs		Allowance		/HH	$0
Temporary Relocation Costs	124	Units	$3,000	/Unit	$372,000
TOTAL RELOCATION COSTS					**$372,000**
III. REHABILITATION COSTS [3]	124	Units	$100,000	/Unit	**$12,400,000**
IV. INDIRECT COSTS [4]					
Architecture, Eng. & Consulting	1.25%	of Acq/Rehab Costs			$999,000
Permits & Fees	124	Units	$3,000	/Unit	$372,000
Taxes, Insurance, Legal & Acctg	0.50%	of Acq/Rehab Costs			$399,500
Marketing & Leasing					$10,000
Developer Fee [5]					$2,500,000
Contingency Allowance	5.00%	of Other Indirect Costs			$214,000
TOTAL INDIRECT COSTS					**$4,494,500**
V. FINANCING COSTS [4]					
Interest During Rehabilitation					
Seller Note [6]	$50,808,000	Loan Amount	3.00%	Interest	$1,524,000
FHA Acq/Rehab Loan [7]	$8,642,000	Loan Amount	7.25%	Interest	$410,127
Taxable Tail	**$41,000,000**	Loan Amount	7.25%	Interest	$1,945,754
Financing Costs					
Construction Loan	$49,642,000	Loan Amount	2.00	Points	$993,000
Permanent Loan	$8,642,000	Loan Amount	2.00	Points	$173,000
Issuance Fees [8]	$49,642,000	Issuance Amount	2.00	Points	$993,000
TCAC Fees [9]					$77,000
LAHD Fees	124	Units	$48	/Unit	$6,000
Capitalized Operating Reserves	$142,272	Mo. Op Exp + DS	6	Months	$854,000
Capitalized Transition Reserves	$217,199	Annual TBS8 Subsidy	1	Year(s)	$217,000
TOTAL FINANCING COSTS					**$6,893,000**
VI. TOTAL ACQ/REHABILITATION COSTS					**$92,834,500**
Acquisition Eligible Basis [10]					$64,984,150
Rehabilitation Eligible Basis					$27,850,350
VII. TEB 50% TEST					
Requested Tax-Exempt Bonds					$49,642,000
Total Acq/Rehabilitation Costs					$92,834,500
TEB 50% Test					**50%**

1 LAHD estimate; includes all of City's acquisition-related costs that will be rolled over to the chosen Developer. Assumes that Project cash flow can
cover operating expenses during holding period and that interest isn't charged on funds used by City to acquire the property.
2 LAHD estimate; assumes 10 existing tenants are over crowded and 19 overincome households will remain in place.
3 LAHD estimate; assumes prevailing wages are required.
4 KMA estimates.
5 Based on maixmum allowable fee by LAHD which is 5% of acquisition basis plus 15% of rehab basis.
6 Assumes the City will roll over the current debt to the new owner, a 12-month rehabilitation period; and a 100% average outstanding balance.
7 FHA Loan plus Taxable Tail total to the TEB amount to meet the TEB 50% Test. (See Section VII.)
8 KMA estimate.

III. NET OPERATING INCOME	$217,199	TBS8 Overhang	$611,400	Net NOI	**$828,599**

1 Assumes 2021 TCAC rents and the following utility allowances: $39/1-bdrm units; $50/2-bdrm units; and $62/3-bdrm units.
2 Assumes 54% of the tenants have portable Tenant Based Section 8 Vouchers.
3 KMA estimates.
4 Assumes new property owner will receive a property tax exemption.

I. PERMANENT FUNDING SOURCES [1]					
A. Tax-Exempt Bonds - Base Rents	$611,400	NOI	1.15	DCR	**$8,642,000**
	7.25%	Interest Rate	$531,652	Debt Service	
B. Tax-Exempt Bonds - TBS8 Overhang		NOI	1.15	DCR	**$0**
	7.25%	Interest Rate	$0	Debt Service	

C. Tax Credit Equity [2]	$32,527,000 Gross Tax Credits	$0.95 /Tax Credit		**$30,901,000**
D. Other Funding Sources [3]				$0
E. Developer Fee Contribution [4]	$2,500,000 Total Developer Fee	78% of Fee		**$1,950,000**
F. Deferred Developer Fee	$2,500,000 Net Developer Fee	0% of Net Fee		**$0**
TOTAL PERMANENT FUNDING SOURCES				**$41,493,000**
II. <u>FINANCIAL GAP CALCULATION</u>				
Total Estimated Development Costs				$92,834,500
(Less) Total Permanent Funding Sources				($41,493,000)
FINANCIAL GAP (LAHD Loan)	124 Units	$414,048 /Unit		**$51,342,000**
III. Tax Credit Calculation		**ACQ** [5]	**REHAB**	**TOTAL**
Eligible Basis		$67,020,000	$22,426,000	
(Less) Voluntary Basis Reduction		0	0	
Requested Eligible Basis		$67,020,000	$22,426,000	$89,446,000
High Cost Area Adjustment		100%	130%	
Adjusted Eligible Basis		$67,020,000	$29,153,800	
Applicable Fraction		85%	85%	
Qualified Basis		$56,667,317	$24,650,367	
Tax Credit Rate		4%	4%	
Annual Tax Credits		$2,266,693	$986,015	$9,050,317
Gross Tax Credits		**$22,666,927**	**$9,860,147**	**$32,527,000**

1 Assumes Agency permanent loan financing.
2 Assumes the automatically awarded 4% Tax Credits if the 50% Test for tax-exempt bonds is met.
3 Assumes County and State funding sources will not be available to the Project.
4 Based on TCAC and LAHD requirements.
5 Assumes a 10-Year Hold Period will be approved by TCAC.