1. INTRODUCTION
This document relays HCIDLA's policies ("HCIDLA RECAP 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 HCIDLA Financing. For purposes of the HCIDLA RECAP Policy, Existing Financing also includes financing originally provided by certain predecessor agencies now under the purview of HCIDLA (e.g., the Community Redevelopment Agency of the City of Los Angeles).

This HCIDLA RECAP Policy will allow HCIDLA to consistently evaluate proposed restructure requests for projects described herein that also require discretionary HCIDLA approvals related to Existing Financing, and reasonably determine amounts, if any, HCIDLA 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 of Los Angeles ("City").

This HCIDLA RECAP 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 may, at his or her sole discretion, waive one or more aspects of the HCIDLA RECAP Policy if justified by the combined benefits to the City, the project, and the project sponsor. HCIDLA reserves the right to create and promulgate rule, requirements and regulations in order effectuate the purposes of this HCIDLA Recap Policy.

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

Further, this HCIDLA 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 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 RECAP 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 RECAP are outlined below.

a) Rehabilitate the City's Affordable Housing Stock
   The objective of the HCIDLA Recapitalization policy is to 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
   The objective of the HCIDLA Recapitalization policy is to preserve affordable housing through the extension of the time period of affordability covenants.

c) Improve the Financial & Managerial Performance of Projects
   The objective of the HCIDLA recapitalization policy is to reduce ongoing operating costs associated with deferred maintenance of projects and when appropriate, to address the problems created by ineffective management.

d) Enhance Long-term Energy and Resource Sustainability profile of the Projects
   The objective of the HCIDLA recapitalization policy is to reduce energy and water consumption in affordable housing projects when possible.

e) To improve disabled access to affordable housing
   The objective of the HCIDLA recapitalization policy is to improve disabled access to affordable housing when possible.
f) Recirculate Affordable Housing Funds
The objective of the HCIDLA Recapitalization policy HCIDLA is seek the repayment of outstanding public debt and to recirculate income into the Affordable Housing Trust Fund to be reinvested in new affordable housing units.

5. 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% of 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 (AHTF) 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 highest 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 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.
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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 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 re-capitalization 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, since 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 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. 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 guide the public in their requests for HCIDLA cooperation and Support.

6. UNDERWRITING REQUIREMENTS

a) Eligible Sponsor
For existing LIHTC projects, the investor limited partner shall have exited the partnership before application to HCIDLA under the these policies (i.e., either the Project shall be owned directly by the sponsor or the sponsor shall fully control the partnership or LLC owning the Project (e.g., has purchased the partnership interest of the investor limited partner either directly or through an affiliate).

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 is seeks to preserve HOME assisted projects that have become financially unviable, and as a result, are at risk of failure or foreclosure. The property must be in distress but disinvestment may not have occurred. Projects that have suffered accelerated deterioration due to mismanagement of the current parties, or their affiliates parties related to the current parties or affiliates, remain involved in the future ownership structure. HCIDLA will consider the property’s history of compliance with Occupancy Monitoring, Portfolio Management, Code and Rent to determine whether a comprehensive physical, financial and managerial assessment by a third party will be required. All entities involved in the new proposed project shall adhere to the City’s 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 and long term operating efficiencies of the Project. HCIDLA will actively work toward improving energy efficiency and water use reduction in the project.
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 lender, and the current owner is unsuccessful in acquiring permission from the other public lenders to have all remaining sales proceeds used to pay down the HCIDLA principal and accrued interest, HCIDLA will accept a prorated amount of the net sales 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. In the absence of said language the proration amount shall be in proportion to the original loan balance in relation to those of the other public lenders. The current owner is expected to negotiate this detail with the other subordinate 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 1st 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 likely 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 GP or Sponsor loan 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. The intent of maximizing the purchase price is to minimize or eliminate the request to write-off the HCIDLA/CRA loan and/ or any accrued interest as well as maximize acquisition tax credit available to the Project. HCIDLA expects the developer to work with their tax professional to prevent, or at worse minimize, such write-offs. 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 6 months prior to the date of the purchase agreement. The appraisal must be prepared by a California State Certified General Appraiser. 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.
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j) Exit Taxes
This HCIDLA Recap Policy requires that the Original Limited Partner exit the ownership entity prior to submitting an application for re-capitalization consideration. Therefore any exit tax obligation shall have been resolved before HCIDLA considers the transaction. In no case will HCIDLA approve the use of Sales Proceeds and/or Reserves to pay for Exit Taxes. HCIDLA will not subordinate its share of Sales proceeds, as stated above, to payment of Exit Taxes.

k) Net Operating Income During Construction
Re-capitalization transactions involve tenant-occupied properties. HCIDLA will require that 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
HCIDLA will allow the TCAC and CDLAC maximum Developer Fee, but will only allow up to 75% of the total Developer Fee attributable to the Project’s rehabilitation basis, or $1,000,000, whichever is less, to be paid from capital resources. (For the purpose of this subsection, HCIDLA may exclude general partner capital contributions from capital resources in the event the general partner and developer are related parties). The remaining portion of the total Developer Fee must be paid from 50% of the Net Operating Income of the project.

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 and shall not be valued as part of the acquisition price. 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.
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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 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. 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.

r) Contractor Requirements
iv. 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.
v. **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.

vi. **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, ad any affiliated subcontractors and suppliers.

7. **ADMINISTRATION**

a) **Fees**
The City will incur costs to process these Projects. Staff time will be incurred by HCIDLA, CAO, City Council and City Attorney, and other departments. Within HCIDLA alone, financial, construction, occupancy monitoring, portfolio management, compliance and accounting, systems, reporting, and executive management staff time will be incurred. Therefore, in order to process these transactions HCIDLA will charge the transaction a fee. A Construction Financing Origination Fee of $30,000 will be charged for the re-capitalization transaction that involves re-structuring public funds. Said fee is due to HCIDLA based on the following schedule:

a. 10% (i.e., $3,000) due at the time of application.
b. 35% (i.e., $10,500) due at the time of Restated Terms and Conditions approval.
c. 25% (i.e., $7,500) due at the time of CDLAC and/or TCAC approval.
d. 30% (i.e., $9,000) due upon closing of the Amended and Restated Loan.

This fee presumes a Bond/4% tax credit transaction and it is in addition to any other Bond Program transaction fee.

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

8. **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 these policies.
b) Re-Casting HCIDLA’s Loan Balances
HCIDLA understands that a re-capitalization 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 other compelling reasons mentioned above. 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, which must then be awarded under 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:
Any re-capitalization presents HCIDLA with the opportunity to revise and update its business terms. Revision of business terms may include, but are not limited to, revising the annual payment structure, the interest being charged, etc. See NOI After Debt Service below.

e) Revisions To HCIDLA’s Regulatory Terms
Any re-capitalization 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, reducing the HOME compliance period to the HOME required minimums.

f) Revisions To CRA Loans
As the Housing Successor Agency to CRA, HCIDLA will service and administer CRA loans in the same manner as HOME and CDBG loans during a re-capitalization 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 economic support this approach. HCIDLA will not consider a transaction that requires forgiveness of principal, nor any proposal 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 worse 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 NOI With Other Public Lenders
If the property has a public lender or lenders in addition to LAHD, 50% of NOI shall be used to pay residual receipts to all public lenders in the proportion of their revised principals. 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, usually in junior position to the 1st deed of trust, will not be eligible for residual receipts payments. LAHD 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, HCID will cooperate with the other public lenders.

9. RELATED PROGRAM REQUIREMENTS

a) HOME Program Requirements
Projects 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, Fair Housing, etc.

b) Uniform Relocation Act (URA)
If applicable based on federal funding, these transactions are going to be handled as acquisitions then URA requires issuance of a voluntary acquisition letter, along with documentation of proof of receipt. In addition to this, HCIDLA collects the appraisal to confirm that the “fair market value” presented in the voluntary acquisition letter is based upon actual third-party analysis. We 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.
10. 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 for the establishment of programmatic approval, along with program-specific underwriting policies.