

Bond Case Briefs

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Orrick: California Debt Limit Allocation Committee Releases Proposed Regulations.

This publication discusses some of the more significant changes that could affect issuers (“**Applicants**”) and borrowers (“**Sponsors**”) in connection with awards of volume cap (“**Awards**”) if California Debt Limit Allocation Committee’s (“**CDLAC**”) proposed regulations were adopted in their current form.

CDLAC released proposed revisions to its regulations (“**regulations**”) on September 23, 2016. Major changes include (i) requiring Applicants to adopt written bond issuance and compliance policies (“**Policies**”), (ii) changing the required form of compliance certificates, (iii) requiring certain new provisions to be added to bond regulatory agreements (“**Regulatory Agreements**”) associated with qualified residential rental projects (“**QRRPs**”); (iv) requiring that CDLAC receive a copy of the recorded Regulatory Agreement for a QRRP before releasing the associated performance deposit, (v) providing for greater post-issuance monitoring of the terms and conditions of the Award; and (vi) imposing conditions on certain types of subordinate cash-flow bonds paid with residual payments.

Additional proposed changes would affect (i) the eligibility of Joint Powers Authority (“**JPA**”) Applicants to apply for an Award, (ii) the term of the qualified project period (“**QPP**”) for acquisition and rehabilitation transactions associated with QRRPs, (iii) filing fees, (iv) general and rural multifamily deals, and (v) projects requesting an assignment and assumption of an existing housing assistance payment contract (“**HAP Contract**”).

Bond Issuance and Compliance Policies

The proposed Regulations would require all Applicants to submit Policies regarding the process of issuing private activity bonds and post-issuance compliance. For QRRP Applicants, the proposed Regulations would require that Policies “be reviewed by counsel having expertise with the federal and state laws pertaining to the issuance or conversion and post-issuance compliance of private activity conduit bonds for consistency with applicable federal and state laws.” Such review would be documented by a letter from such counsel stating that the review has taken place. Policies would also be accompanied by an approving resolution of the Applicant’s governing board or a certificate of the Applicant’s Executive Director, Housing Director or Finance Director with delegated power to make such approvals.

Policies also would be required to include “a description of the fee structure, application and approval process (including TEFRA), threshold eligibility criteria for applicants and projects, long-term regulatory requirements and monitoring practices.” If a contractor were to provide services on behalf of the Applicant, “the Policies [would have to] clarify the relationship between contractor and Applicant and what, if any, rights the contractor [had] to income and obligations generated from issuance activity.”

Additional proposed changes to the Regulations would require that CDLAC review the Policies for

compliance with its Regulations. The requirements would apply immediately to those Applicants who have not received an Award since January 2013 and any new Applicants. All other Applicants would have until December 31, 2017 to comply. An Applicant could request a one-year waiver, if it had not received an Award (presumably since January 2013), but had a 2017 project pending. All such Policies would have to be reauthorized every ten years. For those Applicants that had Policies in place, they would have to be approved by the Applicant in 2006 or later. These proposed revisions are contained in Sections 5000 (definitions) and 5031 of the Regulations.

Conditions on the Issuance of Certain Types of Subordinate Cash-Flow Bonds Paid with Residual Payments

The proposed Regulations introduce restrictions on certain subordinate bonds that are issued to provide permanent financing and paid with cash from residual payments based on cash-flow availability. These are bonds that do not otherwise meet CDLAC's debt service coverage ratios and which (together with any other such bonds) "exceed 5% of the total project cost" ("**Cash-Flow Bonds**"). Such Cash-Flow Bonds include "bonds purchased by a property seller in consideration of the provisions of a purchase and sale agreement."

For applications submitted after December 31, 2016, that include Cash-Flow Bonds, the proposed Regulations would require that the purchaser provide a traveling investor letter from a Qualified Institutional Buyer or an Accredited Investor three days prior to bond issuance, or provide for the issuance of the Cash-Flow Bonds in \$100,000 authorized denominations. Cash-Flow Bonds also would have to comply with the requirements of Section 5062(a).

Further, the proposed Regulations provide that when Cash-Flow Bonds finance project costs, all units identified in the Award, including both the Federally Bond-Restricted Units ("Restricted Units") and other affordable units identified in the Award as income and rent restricted ("Other Restricted Units"), would have to be incorporated into the Regulatory Agreement. The assumptions in the Regulatory Agreement regarding the Other Restricted Units would have to "include the area median income as outlined in the Award, a limitation that tenants pay no more than 30% of their income, and assume 1.5 persons occupy each unit."

These proposed Regulations are contained in Sections 5062(b), 5170 (definitions) and 5220(b).

Monitoring Compliance with Terms and Conditions of the Award

Applicant's Submission of Compliance Certification

The proposed Regulations provide that for those projects receiving an Award prior to December 31, 2016, Applicants will be required to submit annually to CDLAC an Annual Application Public Benefits and Ongoing Compliance Certification via CDLAC's online compliance certification system ("Compliance Certification"). For projects receiving an Award after December 31, 2016, the Applicant would be required to submit the Compliance Certification to CDLAC "every year until completion of the project and every three years thereafter." In both cases, the Compliance Certification would be due by March 1 and Applicants would be subject to penalty (including disqualification) for failure to comply. These proposed revisions are contained in Sections 5144(a) and 5146 of the Regulations.

Sponsor's Verification of Tenant Income

The proposed Regulations provide that for all QRRPs receiving an Award after December 31, 2016, Sponsors will be required to: (a) use HUD Handbook 4350.3 to verify tenant income at initial

occupancy; and (b) annually collect and retain the following income and verification documentation related to all the Restricted Units identified in the Award or as defined in Section 5200(e) of the Regulations: "Tax Credit Allocation Committee ("**TCAC**") Tax Income Calculation ("**TIC**") or equivalent documentation, all associated source income documentation, and evidence of the verifying income computation." Project Sponsors also will be required to provide a TCAC Project Status Report or equivalent report to the Applicant annually in connection with the Applicant's submission of the Compliance Certificate. Sponsors will have to retain this information for ten years. These proposed new Regulations are found in Section 5144(b).

For Non-TCAC QRRPs, Sponsors would have to elect additional compliance options, which would be included in the Award. In addition, these non-TCAC QRRPs would have to designate CDLAC to receive notice of project name and ownership changes, default, and foreclosure as may be provided in the bond documents. These new proposed Regulations are found in Sections 5144(d) and 5145(d).

CDLAC has also proposed revisions to its annual certification of compliance forms for use in all projects receiving allocation after December 2016. Applicants would be required to collect and retain from the Sponsor the applicable Certification of Compliance II as attached in the Award or other comparable form outlined in an Applicant's Policies ("**Sponsor Compliance Certificate**"). The Sponsor would submit the Sponsor Compliance Certificate to the Applicant annually until the Project is completed and then every three years thereafter during an existing regulatory period and/or compliance period. The Sponsor would also provide the Applicant with the applicable Certificate of Completion as provided in the Award or other comparable form outlined in an Applicant's Policies. The Applicant would have to confirm its receipt to CDLAC by March 1 via its online compliance certification system (or such other date as requested by CDLAC). CDLAC would have the right to enforce these requirements through an action for specific performance or other available remedy of the Sponsor. This new proposed Regulation is found in Section 5145(b).

Applicant's Verification and Certification of Tenant Income and Rent

Additional proposed changes provide that after December 31, 2016, an Applicant's compliance with the income and rental requirements of the Restricted Units identified in the Award and the Regulatory Agreement would have to be demonstrated by an initial review of 20% of all management files associated with the Restricted Units and subsequent review every three years thereafter, including review of all newly leased units. Units would be selected at random with a distribution based on unit locations, sizes, and income levels. "For this 20% of files, Applicants [would] review each initial or subsequent occupant and their associated TIC in conjunction with the supporting income verification documentation and make a determination if the project is complying with the income and affordability standards." This review could be performed on-site or through an electronic file audit.

Applicants would also be required to submit a Sponsor Compliance Certificate or equivalent form, which together with the above review would provide Applicants with the ability to report annually to CDLAC regarding compliance with the unit restrictions of the Restricted Units. Records of the income verification process would be kept on file for ten years together with documentation memorializing review and determination of income eligibility. Source income documentation would be retained for one year. These new proposed Regulations are found in Section 5144(c).

CDLAC (or an entity acting on its behalf) would monitor all TCAC QRRPs for compliance with the terms and conditions of the Award, and such projects would be subject to the provisions of the California Code of Regulations regarding the TCAC regulatory agreement.

This new proposed Regulation is found in Section 5145(c).

Regulatory Agreement Revisions

The proposed Regulations provide that for projects receiving an Award after December 31, 2016, the Regulatory Agreement for all QRRPs terminate prior to the end of the Award's affordability term only for:

“(i) [I]nvoluntary noncompliance with the provisions of the Regulatory Agreement caused by fire or other casualty, seizure, requisition, change in a federal law or an action of a federal agency after the bond issuance, which prevents the Issuer, Fiscal agent and/or the Trustee (as applicable) from enforcing such provisions, or (ii) foreclosure, exercise of power of sale, and/or, transfer of title by deed in lieu of foreclosure in connection with a deed of trust directly or indirectly security[ing] repayment of bonds, or condemnation or a similar event, but only if, in the case of the events described in either clause (i) or (ii) above, if the bonds are redeemed within a reasonable period or the proceeds for the event are used to provide a project that meets the requirement of the Regulatory Agreement.”

This new proposed Regulation is found in Section 5220(a).

For projects receiving an Award after December 31, 2016, the proposed changes provide that the Regulatory Agreement for all QRRPs (1) incorporate the Award by reference and as an attachment; (2) have the requisite 30 or 55 year term from the date of 50% occupancy or the commencement of the CDLAC QPP; (3) include all applicable income and affordability requirements outlined in the tax code and the applicable portions of the California Health & Safety Code; (4) clarify that compliance with items not contained within the body of the Regulatory Agreement but referred to in the Award are the responsibility of the Sponsor to report to the Applicant; and (5) list CDLAC as a contact to receive notice of changes in project name, ownership, issuer, and management company as well as a contact to receive notices of defaults associated with rents and income requirements, foreclosure, Regulatory Agreement termination and bond redemption. This new proposed Regulation is found in Section 5220(c).

Finally, CDLAC's proposed Regulations would require receipt of a digital copy of the recorded Regulatory Agreement as an additional condition for release of the Applicant's performance deposit. This proposed revision is contained in Section 5051(a) of the Regulations.

Miscellaneous Proposed Revisions Regarding JPAs, the Term of the QPP, Filing Fees, General and Rural Multifamily Deals and Projects Seeking Assignment and Assumption of HAP Contracts.

JPAs

Another proposed revision to CDLAC's Regulations would restrict applications from its JPA Applicants to projects located within the geographical boundaries of one or more of the JPA members, except for certain projects that are exempted from such requirement under Section 6586.5(c) of the California Government Code related to the Marks-Roos Local Bond Pooling Act of 1985. This proposed revision is contained in Sections 5031 and 5033 of the Regulations.

Term of the QPP

For acquisition and rehabilitation QRRPs, CDLAC's proposed Regulations would amend its definition of QPP to acknowledge that, in certain circumstances, the income and rent restrictions identified in

the Award begin 12 months after the bond issuance date and end the later of 31 years (and presumably 56 years during an open application process) after the bond issuance date or the date on which the bonds are no longer outstanding. This additional time would be available for such projects unless less than 10% of the units were available for occupancy within 60 days of the earlier of the date of project acquisition or the issuance date of the bonds. This proposed revision is contained in Section 5192 of the Regulations.

Filing Fees

CDLAC's proposed Regulations further increase its filing fees to review an application for an Award from \$600 to \$1,200 and introduce an additional \$600 fee to review an application for a Supplemental Award. Both fees would be nonrefundable, but would be credited against the total filing fee. This proposed revision is contained in Section 5054(a) of the Regulations.

General and Rural Multifamily Allocation Limits

The proposed Regulations also provide that bond allocation limits for General and Rural Multifamily Pools are now subject to limits on a per unit basis as provided in Section 5233 of the Regulations.

Assignment and Assumption of HAP Contracts

Finally, CDLAC's proposed Regulations would require that all projects that request an assignment and assumption of an existing HAP Contract submit an application to HUD by the CDLAC application date. No later than four calendar days prior to the first posting, CDLAC would require that it receive a letter from HUD stating that it will approve the assignment and assumption of the HAP Contract prior to the expiration of the Award. This proposed revision is contained in Section 5255(d) of the Regulations.

Next Steps

These proposed revisions to the Regulations are available for public comment until October 26, 2016.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.