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Re: ***DOF's Untenable Legal Position with Respect to Loan Commitment Letter Agreements***

Dear Mr. Pavao, Ms. Harris, Mr. Spear, Mr. Szalay, and Ms. Rockwell:

Our office represents the City of Santa Monica ("City") in its capacity as the Successor Agency ("Successor Agency") to the former Santa Monica Redevelopment Agency ("RDA") and in its capacity as the entity that has assumed the housing functions of the RDA.

This letter voices our objection to the Department of Finance's ("DOF's") policy of disqualifying any loan commitment letter agreements (even any executed before AB1x 26 went into effect) as an "enforceable obligation" within the meaning of AB1x 26. The City objects to this policy on the grounds that it constitutes an underground regulation, is contrary to well established contract law and regulations promulgated in accordance with the Administrative Procedure Act, and ignores Health and Safety Code section 34171(d)(3), which specifically provides that contracts or agreements for the provision of housing properly authorized under the Community Redevelopment Law shall not be deemed void.

This letter additionally objects to the DOF's rejection of seventy-nine (79) housing vouchers issued to preserve affordable housing for seventy-nine (79) formerly homeless low income seniors. The housing vouchers were in effect prior to the effective date of AB1x 26 and Health and Safety Code section 34171(d)(3) specifically provides that contracts or agreements for the provision of housing properly authorized under the Community Redevelopment Law shall not be deemed void.

### **BACKGROUND**

#### 1. Housing Trust Guidelines.

Until the effective date of AB1x 26 and in accordance with the Community Redevelopment Law (Health and Safety Code sections 33000 *et seq.*)("the CRL"), the former RDA had an obligation to use not less than twenty percent (20%) of its tax increment (referenced hereinafter as "Set Aside Funds") for the purposes of increasing, improving, and preserving the City's supply of low and moderate income housing. As noted in a report prepared for the Senate Rules Committee, dated September 30, 2010 (a part of which is enclosed for your reference under Tab 1), the former RDA had an exemplary record in the administration of its Set Aside Funds.

The RDA's affordable housing efforts were implemented in accordance with the CRL as well as the City's Housing Trust Fund Guidelines (the "Guidelines"), which were originally adopted in 1998. The Guidelines set forth the eligible uses for various sources of public funding, including Set Aside Funds. Similar to other housing programs throughout the state, the Guidelines contemplate phased financing of eligible affordable housing projects, beginning with loans to finance predevelopment and/or property acquisition ("Phase I") followed by loans to finance construction ("Phase II"). Because affordable housing projects have limited operating income and, in most cases, cause a negative residual land value, the Guidelines contemplate that repayment of a Phase I loan will be deferred and rolled over into the Phase II loan, and the repayment of the Phase II loan will be deferred for as long as the Project operates as affordable housing, which is typically no less than fifty-five (55) years after the affordable units are constructed or rehabilitated, and affordability covenants are recorded on the property. The Guidelines also contemplate that affordable housing projects will be financed using layered financing sources, including federal and state tax credits, state bond allocations, institutional lenders, and other "soft" public financing sources (e.g., State MHP financing).

#### 2. Tax Credit Regulations

State and federal tax credit allocations (collectively, "Tax Credits") are administered by the State's Tax Credit Allocation Committee ("TCAC"). Tax Credits are awarded by TCAC in accordance with implementing regulations that have been adopted in accordance with the Administrative Procedure Act (Gov't Code §§ 11340 *et seq.*)("the APA").

TCAC's regulations are codified in the California Code of Regulations, Title 4, Division 17, Chapter 1, sections 10300 *et seq.* ("TCAC Regulations"). Similar to the Guidelines, the TCAC regulations contemplate that eligible affordable housing projects will be financed using layered financing from multiple sources, including tax credits, bond allocations, institutional lenders and "soft" public lenders like the former RDA. To receive tax credits, applications must conform to Section 10322 (Application Requirements) of the TCAC Regulations. In particular,

Section 10322(h)(15) of the TCAC Regulations requires that each application include the following:

Financing Plan. A detailed description of the financing plan, and proposed sources and uses of funds, to include construction, permanent, and bridge loan sources, and other fund sources, including rent or operating subsidies and reserves. *The commitment status of all fund sources shall be described, and non-traditional financing arrangements shall be explained.* (Emphasis added.)

Applications for 9% federal tax credits are competitively awarded by TCAC, based upon scoring of applications. In particular, Section 10325(c)(1)(C) of the TCAC Regulations provides that 20 points will be awarded for conclusive evidence that "any new public funds have been *firmly committed* to the proposed project and require no further approvals."

Section 10325(f)(8) of the TCAC Regulations requires that applications only be deemed complete by TCAC by meeting certain threshold requirements, including "a presentation of conclusive, documented evidence" that "[a]ll *deferred payment-financing, grants, and subsidies shown in the application are "committed" at the time of application.* (Emphasis added.)

Section 10325(f)(8)(A)-(C) of the TCAC Regulations establishes the parameters to evidence such commitment, as follows:

- (A) *Evidence provided shall signify the form of the commitment, the loan, grant or subsidy amount, the length of the commitment, condition of participation, and express authorization from the governing body, or an official expressly authorized to act on behalf of said governing body, committing the funds, as well as the applicant's acceptance in the case of privately committed loans.*
- (B) *Commitments shall be final and not preliminary, and only subject to conditions within the control of the applicant, with one exception, the attainment of other financing sources including an award of Tax Credits.*

- (C) *Fund commitments shall be from funds within the control of the entity providing the commitment at the time of application.* (Emphasis added.)

Beginning from January 2011, the State Legislature debated the dissolution of redevelopment throughout the State. Because of the confusion generated by this debate, TCAC held several workshops for tax credit applicants and then issued FAQs dated March 10, 2011. A copy is enclosed for your reference under Tab 2. FAQ #8 provided, as follows:

**8. Will TCAC honor award letters from the California Department of Housing and Community Development (HCD) and Redevelopment Agencies (RDAs)?**

Yes. For the first round applicants in 2011, TCAC will honor these award letters. *Currently there is no formal basis upon which to question the validity of these commitments.* If this changes, TCAC will publish guidance for projects with these types of commitments. (Emphasis added.)

3. The 2010 Master Cooperation Agreement between City and RDA

In accordance with sections 33445 and 33334.2(e) of the CRL, the City and RDA entered into a Master Cooperation Agreement, dated September 1, 2010. The Master Cooperation Agreement required the City to undertake certain public improvement and affordable housing projects in consideration for the RDA's reimbursement of the City's costs through the payment of tax increment. A copy of the Master Cooperation Agreement, together with an Enforceable Obligations Payment Schedule, is enclosed for your reference under Tab 3.

4. Loan History for 2802 Pico Boulevard

Following the Guidelines and in accordance with the CRL, the former RDA (as "Lender") and Community Corporation of Santa Monica ("CCSM"), a California nonprofit public benefit corporation (as "Borrower") entered into that Certain Acquisition and Predevelopment Loan Agreement on February 2, 2009 ("Acquisition Loan Agreement") whereby the former RDA agreed to loan CCSM \$5,595,897 to finance CCSM's acquisition of land and pre-development (including design and procurement of entitlements) for thirty-three (33) affordable housing units on the site known as 2802 Pico Boulevard, in the City of Santa Monica. A copy of the Acquisition Loan Agreement is enclosed for your reference under Tab 4.

The Acquisition Loan Agreement specifically contemplated that CCSM would apply for tax credits and procure construction loan financing to construct the 33 affordable units. Following TCAC Regulations, CCSM submitted an application to TCAC for an award of federal tax credits and included the RDA's loan commitment letter agreement, dated March 7, 2011, as evidence of the former RDA's commitment of construction and permanent loan financing in the

amount of \$9,207,402, including the \$5,595,897 in funds previously disbursed by the RDA to CCSM under the 2009 Acquisition Loan Agreement. A copy of the commitment letter is enclosed for your reference under Tab 5.

In accordance with TCAC Regulations, the RDA's March 7, 2011 loan commitment letter agreement stated that the loan commitment was only contingent upon the award of tax credits. The loan commitment letter agreement included amount of the loan, the interest rate, the terms for repayment, the required security, the provision for recordation of affordable covenants, occupancy restrictions, rent restrictions, disbursement conditions, and other conditions for the loan. The loan commitment letter agreement was executed by the RDA's Executive Director and CCSM's representative.

On June 22, 2011, CCSM received its Preliminary Reservation Letter from TCAC for the award of federal tax credits over the period of ten years. The Preliminary Reservation Letter states that it is conditioned upon the Project Applicant constructing, rehabilitating or acquiring and rehabilitating the Project in accordance with the application for low income housing tax credits submitted to TCAC and is subject to full compliance by the Applicant with the TCAC Regulations. Among other things, the Preliminary Reservation Letter required CCSM to procure a Letter of Intent ("LOI") from the projects' equity partner, evidence of continuing firm commitments from public funding sources, and required CCSM to pay TCAC a fee in the amount of \$39,480. The Preliminary Reservation Letter was executed by William J. Pavao. A copy is enclosed for your reference under Tab 6.

Following receipt of CCSM's reservation letter, and acting under its authority under the Master Cooperation Agreement, the City entered into a Construction Loan Agreement with 2802 Pico, L.P. ("Developer"),<sup>1</sup> dated November 29, 2011, wherein the City agreed to loan the Developer the amount of \$9,207,402, including the \$5,595,897 in funds previously disbursed by the RDA to CCSM under the 2009 Acquisition Loan Agreement. The City's source of funding for the balance of the loan was tax increment pledged by the RDA to the City under the Master Cooperation Agreement for construction of affordable housing projects. A copy of the Loan Agreement is enclosed for your reference under Tab 7. Following the Guidelines, the construction loan agreement deferred loan repayment for fifty-five (55) years.

In reliance upon the award of tax credits from TCAC and the City's commitment under the Construction Loan Agreement, CCSM then procured tax credit equity from its limited partner in the amount of \$2,359,354 for construction financing and \$9,376,549 in permanent financing and a bank loan from Bank of America in the amount of \$7,591,541 for construction financing and \$982,620 permanent financing.

Construction of the Project is 50% complete. Fifty-five year affordability covenants were recorded on the property on December 2, 2011. The City's subordinate deed of trust, the

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<sup>1</sup> 2802 Pico, LP is a limited partnership with CCSM as the general partner and Wincopin Circle LLP, a Maryland limited liability limited partnership, as the tax credit equity limited partner.

regulatory agreement required by TCAC (and IRS regulations), and deeds of trust recorded by the institutional lender have also been recorded against the property.

5. Loan History for 430-508 Pico Boulevard

The loan history for 430-508 Pico Boulevard is similar to that for 2802 Pico Boulevard, except as to the following particulars:

The Acquisition and Predevelopment Loan for the amount of \$6,223,333 was executed on January 12, 2009 by and between the RDA and CCSM. A copy is enclosed for your reference under Tab 8.

The Project consists of construction of thirty-two (32) affordable units located at 430-508 Pico Boulevard, in the City of Santa Monica.

The City and RDA entered into a loan commitment letter agreement with CCSM on June 28, 2011 in the amount of \$10,947,475, including \$6,223,333 in funds previously disbursed by the RDA under the 2009 Acquisition and Loan Agreement. A copy is enclosed for your reference under Tab 9.

CCSM submitted the RDA loan commitment letter agreement to TCAC as part of its application for federal tax credits and TCAC issued its Preliminary Reservation Letter awarding federal tax credits on September 28, 2011. A copy is enclosed for your reference under Tab 10.

The City entered into a certain Construction Loan Agreement with 430 Pico, L.P. ("Developer"),<sup>2</sup> dated January 26, 2012, wherein the City agreed to loan the Developer the amount of \$10,947,475, including the \$6,223,333 RDA funds already disbursed under the Acquisition Loan Agreement. A copy of the Loan Agreement is enclosed for your reference under Tab 11.

CCSM procured \$1,747,147 in tax credit equity for construction financing and \$6,988,588 for permanent financing for the project. CCSM procured \$5,791,684 in construction financing and \$960,072 in permanent financing from Citi Community Capital for the project.

The project is 40% complete. Fifty-five year affordability covenants were recorded on March 15, 2012.

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<sup>2</sup> 430 Pico, LP is a limited partnership with CCSM as the general partner and Enterprise neighborhood Partners IV LLP as the tax credit equity limited partner.

6. Loan History for 1942, 1946, 1948, 1950 & 1954 High Place and 2345 & 2349 Virginia Avenue ("High Place West")

The loan history for High Place West is similar to that for 2802 Pico Boulevard, except as to the following particulars:

The RDA and CCSM entered into a Program Loan, dated August 14, 2002, to acquire, rehabilitate, and operate thirteen (13) affordable dwelling units. The Program Loan amount was \$1,885,000. The Program Loan was amended and restated on June 23, 2006 to modify the project scope to new construction of forty-seven (47) affordable units with additional funding for the project. The Program Loan was amended a second time on November 30, 2009 to provide additional funding for off-site improvements for the Project. Copies of the Program Loan agreements are enclosed for your reference under Tab 12.

The City and RDA entered into a loan commitment letter agreement with CCSM on July 14, 2010, in the amount of \$12,020,481, including \$4,938,111 disbursed by the RDA under the Program Loan agreements. A copy is enclosed for your reference under Tab 13.

CCSM submitted the loan commitment letter agreement as part of its TCAC application and TCAC issued its Tax Exempt Reservation Letter on July 20, 2011. A copy is enclosed for your reference under Tab 14.

The City entered into that certain Construction Loan Agreement with High Place West, L.P. ("Developer"),<sup>3</sup> dated September 16, 2011, wherein the City executed a construction/permanent loan in the Developer the amount of \$12,020,481, including \$4,938,111 in funds disbursed by the RDA under the Acquisition Loan Agreement. A copy is enclosed for your reference under Tab 15.

CCSM procured \$940,042 in tax credit equity for construction financing and \$6,266,946 for permanent financing for the project. CCSM procured \$11,500,000 in construction bond financing and permanent bond financing through Wells Fargo Bank.

Bond allocations are awarded by the California Debt Allocation Committee ("CDLAC") in accordance with implementing regulations that have been adopted in accordance with the APA. CDLAC's regulations are codified in the California Code of Regulations, Title 4, Division 9.5, Chapter 1, Article 1, sections 5000 *et seq.* ("CDLAC Regulations"). Section 5230 of the CDLAC Regulations requires evidence of public fund commitments in bond applications, as follows:

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<sup>3</sup> High Place West, L.P. is a limited partnership with CCSM as the general partner and Wincopin Circle LLP and Enterprise Neighborhood Partners IV LLP as the tax credit equity limited partner.

- (1) Applications that include Public Funds as a permanent funding source are eligible for points.

*All Public Funds must be committed by a public entity at the time of Application. Evidence provided shall signify the form of the commitment, the amount of the loan, grant or subsidy, the length of the term of the commitment, conditions of participation, express authorization from the governing body or an official expressly authorizes to act on behalf of said governing body, committing the funds, and the Project Sponsor's acceptance. Commitments shall be final and only subject to conditions within the control of the Project Sponsor. Funding commitments shall be from funds within the control of the entity making the commitment at the time of the Application. One (1) point will be awarded for every dollar of Public Funds committed as a percentage of total development costs (minus developer fees) rounded to the nearest whole number. (Emphasis added.)*

Because the CDLAC Regulations require evidence of a "firm" loan commitment from the public entity providing public financing, the Developer submitted the City/RDA loan commitment letter agreement as part of its bond application to CDLAC.

The project is 95% complete. Fifty-five year affordability covenants were recorded on September 21, 2011.

7. Loan History for 1924 & 1930 Euclid Street, 1753 18<sup>th</sup> Street, and 1754 19<sup>th</sup> Street ("FAME")

The loan history for FAME is similar to that for 2802 Pico Boulevard, except as to the following particulars:

The Acquisition and Predevelopment Loan ("Program Loan") for the amount of \$4,424,711 was entered into on January 12, 2009 by and between the RDA and FAME. A copy is enclosed for your reference under Tab 16.

The Project is for construction of forty-nine (49) affordable units located at 1924 & 1930 Euclid Street, 1753 18<sup>th</sup> Street, and 1754 19<sup>th</sup> Street, in the City of Santa Monica.

The City and RDA entered into a loan commitment letter with FAME on March 7, 2011 in the amount of \$11,475,000, including \$4,424,711 in funds previously disbursed by the RDA under the 2009 Acquisition and Loan Agreement. A copy is enclosed for your reference under Tab 17.

FAME submitted the RDA loan commitment letter agreement as part of its TCAC application and TCAC issued its Preliminary Reservation Letter awarding federal tax credits on May 18, 2011. A copy is enclosed for your reference under Tab 18.

The City entered into that certain Loan Agreement with FAME Santa Monica Senior Apartments, L.P. ("Developer"),<sup>4</sup> dated November 29, 2011, wherein the City agreed to loan the Developer the amount of \$11,475,000, including the Set Aside Funds already disbursed under the Acquisition Loan Agreement. A copy is enclosed for your reference under Tab 19.

FAME procured \$1,032,866 in tax credit equity for construction financing and \$4,664,962 for permanent financing for the project. FAME procured \$8,422,205 in construction financing and \$960,072 in permanent financing from Citibank for the project.

The project is 30% complete. Fifty-five year affordability covenants were recorded on December 1, 2011.

#### 8. Loan History for 1943–1959 High Place ("High Place East")

The loan history for High Place East is similar to that for 2802 Pico Boulevard, except as to the following particulars:

The RDA and CCSM entered into a Program Loan, dated August 16, 2002, to acquire, rehabilitate, and operate fourteen (14) affordable dwelling units. The Program Loan amount was \$2,002,000. The Program Loan was amended and restated on June 23, 2006 to modify the project scope to new construction of forty-five (45) affordable units with additional funding for the project. The Program Loan was amended a second time on November 30, 2009 to provide additional funding for off-site improvements for the Project. Copies of the Program Loan agreements are enclosed for your reference under Tab 20.

The City and RDA issued a loan commitment letter to CCSM on March 9, 2011, for the amount of \$13,016,025, including \$4,426,155 previously contracted under the Program Loan agreements. The City reaffirmed its loan commitment on March 7, 2012. Copies of the commitments are enclosed for your reference under Tab 21.

CCSM submitted the loan commitment letter as part of its TCAC application and TCAC issued its Tax Credit Reservation Letter on July 11, 2012. CCSM also submitted the loan commitment letter as part of its CDLAC application for a tax-exempt bond allocation and CDLAC issued its Bond Allocation Reservation Letter on May 16, 2012. Copies are enclosed for your reference under Tab 22.

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<sup>4</sup> FAME Santa Monica Senior Apartments, L.P. is a limited partnership with FSMRC Senior Apartments, LLC, as the managing general partner and Squier ROEM SM, LLC, as the administrative general partner.

CCSM was awarded a tax credit allocation of \$7,985,000 from the California Tax Credit Allocation Committee for construction/permanent financing, as well as an allocation of \$12,000,000 in tax-exempt bond financing from the California Debt Limit Allocation Committee, for the project.

If CCSM's contracts with the City are impaired, CCSM would suffer substantial adverse consequences, including loss of capital, wasted funds, damaged credit rating, and potential bankruptcy. A copy of a letter from Sarah Letts, Executive Director of Community Corporation of Santa Monica is attached hereto as Tab 23.

#### 9. Loan History for 520 Colorado Avenue

The loan history for 520 Colorado Avenue is similar to that for 2802 Pico Boulevard, except as to the following particulars:

The Acquisition and Predevelopment Loan for the amount of \$3,645,422 was executed on December 15, 2010 by and between the RDA and Step Up on Second Street, Inc. A copy is enclosed for your reference under Tab 24.

The Project consists of construction of thirty-four (34) affordable units located at 520 Colorado Avenue, in the City of Santa Monica.

The RDA issued a loan commitment letter to Step Up on March 9, 2011 for the amount of \$5,041,255, including \$3,645,422 in funds previously contracted under the 2010 Acquisition and Loan Agreement. A copy is enclosed for your reference under Tab 25.

The City entered into that a Construction Loan Agreement with Step Up On Colorado, L.P. ("Developer"), dated January 25, 2012, wherein the City agreed to loan the Developer the amount of \$5,041,255, including the \$3,645,422 RDA funds previously contracted and partially disbursed under the Acquisition Loan Agreement. A copy of the Loan Agreement is enclosed for your reference under Tab 26.

Fifty-five year affordability covenants were recorded on January 31, 2012.

#### 10. Senior Vouchers

In accordance with the mandate of the CRL to increase, improve and preserve the City's supply of affordable housing, the City committed part of the tax increment that it received from the RDA under the Master Cooperation Agreement to provide rental subsidies to very low income seniors who were homeless or at risk of homelessness. The use of Set Aside Funds for this purpose was specifically authorized under Health and Safety Code section 33334.2(e)(8).

Seventy-nine (79) of these vouchers (collectively "the Vouchers") are now in jeopardy. Each of the Vouchers was implemented through a Housing Assistance Payments Contract ("HAP

Contract”), which was executed by the City’s Housing Authority and the owner of the subsidized unit on behalf of the tenant well before AB1x 26 went into effect. The title caption on the first page of the HAP Contract reads as follows: “HOUSING ASSISTANCE PAYMENT CONTRACT (HAP CONTRACT), REDEVELOPMENT AGENCY RENTAL ASSISTANCE”.

In accordance with the HAP Contract, the tenant’s lease term renews automatically on an annual basis until the tenant’s departure or unless certain conditions are met, which conditions are described in the contract. A copy of one HAP Contract is enclosed for reference under Tab 27 and copies of all of the HAP contracts for the seventy-eight (78) remaining tenants are available upon request. The enclosed HAP Contract shows the initial date of the lease term as December 10, 2010.

The importance of the Vouchers to the lives and wellbeing of these tenants cannot be overstated. Many of these seniors lived on the streets for extended periods before they became tenants under the HAP program. If these vouchers are terminated, many of these seniors will be faced with the prospect of returning to the streets if the RDA’s subsidy is discontinued. A declaration of one of these tenants is enclosed for your reference under Tab 28.

#### 11. DOF’s Review of the Housing Asset List

As the successor housing agency to the former RDA, the City elected to retain the former RDA’s housing assets. In accordance with Health and Safety Code section 34176(a), the City submitted to the DOF a list of all of the housing assets (“Housing Asset List”) with an explanation of how each asset on the list satisfies the definition of “housing asset” within the meaning of Health and Safety Code section 34176(e).

The Housing Asset List was submitted on forms provided by the DOF, including Exhibits A through G. Exhibit C contained a list of the six housing projects referenced above as well as the seventy-nine (79) senior housing vouchers. After the City’s submittal of the Housing Asset List, DOF staff analyst, Ms. Veronica Green, contacted City staff to request additional information on the assets listed under Exhibit C, a copy of which is enclosed for your reference under Tab 29. During this correspondence, Ms. Green requested documentation evidencing loan commitments executed by June 27, 2011, *excluding commitment letters*. See enclosed e-mail from Veronica Green under Tab W. Notwithstanding Ms. Green’s directive to exclude commitment letters, City staff submitted all of the loan documentation to the DOF’s analyst for review, including the acquisition loan agreements and commitment letter agreements. The City also submitted one HAP contract. Shortly thereafter, the City received a letter from the DOF, dated August 31, 2012, objecting to the six (6) affordable housing projects and seventy-nine (79) senior housing voucher leases listed on Exhibit C, as follows:<sup>5</sup>

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<sup>5</sup> While Exhibit C included six (6) affordable housing construction projects, the City is only contesting the four projects that received tax credits and closed on construction financing.

- Exhibit C, Items 1 through 6 and Exhibit D, Items 27, 59, 63, 72, and 74 – The encumbrances do not qualify as housing assets. *The regulatory agreements executed after June 27, 2011 are between the City and a third party. HSC section 34171(d)(2) states that agreements between the city that created the redevelopment agency and the former redevelopment agency are not enforceable obligations. Also, HSC section 34163(b) prohibits an agency from entering into contracts with any entity for any purpose after June 27, 2011.* (Emphasis added.)
- Exhibit C, Item 8 – The encumbrance for senior low and moderate housing does not qualify as a housing asset because these contracts are between the City and a third party. *HSC section 34171(d)(2) states that agreements, contracts, or arrangements between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency are not enforceable obligations.* (Emphasis added.)

Based upon the wording of DOF's objections, it appears that the DOF analyst failed to consider the following facts:

- (1) the financing of the four affordable housing projects began in 2009, as evidenced by the acquisition and predevelopment loan agreements executed in 2009;
- (2) the predevelopment/acquisition loans, commitment letter agreements and construction loans clearly contemplated two phased financing;
- (3) the outstanding balances of these acquisition/predevelopment loans were rolled into the construction loans, which is customary practice for public financing of affordable housing, and repayment of these balances were deferred until expiration of the affordability covenants;
- (4) the loan commitment letter agreements evidenced pre-existing commitments by the RDA to provide construction and permanent loan financing for these projects;
- (5) these loan commitment letter agreements were relied upon by six affordable housing developers, two state agencies (TCAC and CDLAC), the developers' tax credit equity partners, and the institutional lenders (collectively, "Third Parties") that provided the last layers of financing for these projects;
- (6) all of the HAP Contracts were executed in 2010;
- (7) the RDA relied upon the City to implement the RDA's affordable housing obligations under the CRL through the Master Cooperation Agreement;
- (8) the City relied upon the tax increment provided by the RDA to carry out its affordable duties under the Master Cooperation Agreement; and

(9) the Master Cooperation Agreement remained in effect until February 1, 2012.

For the reasons, below, the City objects to DOF's determination that these assets are not Housing Assets within the meaning of Health and Safety Code section 34176(e).

## LEGAL ANALYSIS

### I.

#### THE REFUSAL TO CONSIDER ANY COMMITMENT LETTER AGREEMENT AS AN ENFORCEABLE OBLIGATION CONSTITUTES AN UNDERGROUND REGULATION

1. The DOF is subject to the Administrative Procedure Act.

The Administrative Procedure Act (Government Code sections 11340 et seq.) ("APA") governs state agencies in adopting, amending, and repealing administrative rules and regulations and the procedure for administrative adjudication by the statewide agencies to which it is expressly made applicable. A "state agency" includes every state office, officer, department, division, bureau, board, and commission. Cal. Gov't Code § 11000. The DOF is a state agency. Cal. Gov't Code § 13000. Therefore, the DOF is subject to the APA.

2. DOF's failure to consider any loan commitment letter agreement as an enforceable obligation constitutes an underground regulation.

Section 11340.5(a) of the APA provides that

No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in Section 11342.600, unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter.

Section 11342.600 of the APA defines a "regulation" as every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure.

A regulation subject to the APA has two principal identifying characteristics. First, the agency must intend its rule to apply generally rather than in a specific case. However, the rule need not apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided. *Tidewater Marine Wester, Inc. v. Bradshaw*, 14 Cal. 4th 557 (1996). Second, the rule must implement, interpret, or make specific the law enforced or administered by the agency, or govern the agency's procedure. *Id.*

By refusing to consider any commitment letter agreement between the former RDA and a third party as an enforceable obligation within the meaning of Health and Safety Code section 34171(d)(1), the DOF has created a regulation of general applicability that is subject to the APA.

A regulation may be declared invalid due to a substantial failure to comply with the APA provisions on rulemaking, which generally require notice of the proposed regulation, an opportunity for public comment, and filing with the Secretary of State before the rule is adopted. Cal. Gov't Code §§ 11343-11344.

DOF has not formally proposed any regulation regarding the enforceability of commitment letter agreements in accordance with the APA's rulemaking procedure. Therefore, its general policy of refusing to consider any commitment letter agreement as an enforceable obligation constitutes an "underground" regulation and has no legal effect. The DOF should either follow the rulemaking procedure or repudiate the policy and evaluate each commitment letter agreement in accordance with established contract law.

## II.

### **DOF'S FAILURE TO CONSIDER ALL OF THE LOAN DOCUMENTS FOR THESE PROJECTS IS CONTRARY TO WELL ESTABLISHED CONTRACT LAW**

As a preliminary matter, the enforceability of the affordable housing loan documents should be determined by applying the rules that generally apply to the formation and enforceability of contracts under California law. "All contracts, whether public or private, are to be interpreted by the same rules unless otherwise provided by the Civil Code. [citations omitted] 'California cases uniformly refuse to apply special rules of law simply because a governmental body is a party to a contract.'" *Retired Employees Association of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1179, quoting *MF Kemper Canst. Co. v. City of L.A.* (1951) 37 Cal.2d 696, 704.

1. In accordance with statutory contract law, the predevelopment and acquisition loan, loan commitment letter agreement, and construction loan should be viewed as one transaction – an agreement to finance the construction of affordable housing.

Civil Code section 1642 provides that “[s]everal contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together.” Whether a contract is separable depends upon its language and subject matter, and this question is one of construction to be determined by a court according to intention of the parties. Furthermore a series of documents through which agreement is expressed must be construed collectively in ascertaining the parties’ whole contract. *Katemis v. Westerlind*, 120 Cal. App. 2d 537 (1953).

In the case at hand, the acquisition and predevelopment loans, commitment letters and construction/permanent loans collectively evidence a single agreement – that the parties would cooperate in the provision of affordable housing. When the RDA executed the predevelopment and acquisition loans, it unequivocally demonstrated its intent to be bound to complete construction of these affordable housing projects. Otherwise, there would be no means of justifying the waste in public resources that would occur if no such commitments were made.

DOF’s attempt to sever the construction loans from the other loan documents pre-dating AB 1x 26 is not supported by either the language or subject matter of the loan documents *or* evidenced by the actions of the developers in procuring construction financing, the state in awarding tax credits and bond allocations, the tax credit equity investors and institutional lenders, who also made commitments based upon the RDA’s and/or City’s financing commitments.

2. The fact that more detailed documents were to be subsequently entered into did not make the loan commitment letter agreements unenforceable.

It is not uncommon for parties to reach agreement on the essential terms of a deal, with the understanding that they will enter into a more comprehensive formal writing at a later date. California courts have long recognized that this does not prevent the initial agreement from being enforceable as of the date of its making. Each of the loan commitment letter agreements set forth the essential terms of the RDA’s financing, including the amount, the purpose, the loan term, the interest rate and the repayment. It also clearly set forth the additional matters that would be addressed in the loan documents. “[N]either law nor equity requires that every term and condition of an agreement be set forth in the contract [Citations]. ‘The usual and reasonable conditions of such a contract are, in the contemplation of the parties, a part of their agreement.’” *Elite Show Services, Inc. v. Staffpro, Inc.* (2004) 119 Cal.App.4th 263, 269 (emphasis added), quoting *King v. Stanley* (1948) 32 Cal.2d 584, 588; *Hennefer v. Butcher* (1986) 182 Cal.App.3d 492, 500; *Okun v. Morton* (1988) 203 Cal.App.3d 805, 818 (petition for review denied).

3. The loan commitment letter agreements were sufficiently certain to be enforceable.

Even if the RDA and/or City had refused to enter into the construction loan agreements after issuance of the commitment letter agreements, it would not have relieved the RDA or City of its obligations under the loan commitment letters. Because the loan commitment letters expressly set forth the essential terms of the construction loans and because the remaining terms were capable of being made certain, the RDA and/or City would have remained bound by the loan commitment letters even in the absence of the construction loan agreements, and the developers could have obtained specific performance or damages for breach.

As noted above, there is no requirement that a contract must contain every term and condition in order to be enforceable. “The usual and reasonable terms found in similar contracts can be looked to, unexpressed provisions of the contract may be inferred from the writing, external facts may be relied upon, and custom and usage may be resorted to in an effort to supply a deficiency if it does not alter or vary the terms of the agreement.” [Citation.] ‘If the parties have concluded a transaction in which it appears that they intend to make a contract, the court should not frustrate their intention if it is possible to reach a fair and just result, even though this requires a choice among conflicting meanings and the filling of some gaps that the parties have left.’ [citation omitted] ... Even when the uncertainty of a written contract goes to ‘the precise act which is to be done’ (Civ. Code, §3390), ‘extrinsic evidence is admissible to determine what the parties intended. [Citations.] It is only when the extrinsic evidence fails to remove the ambiguity that specific performance must be refused.’ [Citation.]” *Hennefer v. Butcher* (1986) 182 Cal.App.3d 492, 500-501 (emphasis added); cited in *Okun v. Morton* ( 1988) 203 Cal.App.3d 805, 817, 819 (petition for review denied).

The California Supreme Court’s holdings in this regard reflect a longstanding concern for the inviolability of contracts. “The law does not favor but leans against the destruction of contracts because of uncertainty; and it will, if feasible, so construe agreements as to carry into effect the reasonable intentions of the parties if that can be ascertained.” [Citations] Unexpressed provisions of a contract may be inferred from the writing or external facts.” *California Lettuce Growers, Inc. v. Union Sugar Company* (1955) 45 Cal.2d 474, 481-482, quoting *McIllmoil v. Frawley Motor Co.*, 190 Cal. 546, 549. The Court recently reaffirmed this rule. “Even when a written contract exists, [e]vidence derived from experience and practice can now trigger the incorporation of additional, implied terms.” [Citations] Implied contractual terms ‘ordinarily stand on equal footing with express terms.’” *Retired Employees Association of Orange County, Inc. v County of Orange* (2011) 52 Cal. 4111 1171, 1179, quoting *Scott v. Pacific Gas & Electric Co.* (1995) 11 Cal.4th 454, 463.

As discussed above, loan documents that provide phased financing with Set Aside Funds are customary and standardized. Because the developers are experienced in affordable housing financing, they understand when entering into predevelopment and acquisition loan agreements that the repayment of these loans will be rolled over into the construction loans, which will then be deferred for 55 years after completion of construction and recordation of the affordability covenants. Otherwise, the financing of these affordable housing projects is not feasible. “It is the

general rule that when there is a known usage of the trade, persons carrying on that trade are deemed to have contracted in reference to the usage unless the contrary appears; that *the usage forms a part of the contract*, and that evidence of usage is always admissible to supply a deficiency or as a means of interpretation where it does not alter or vary the terms of the contract.” *California Lettuce Growers, Inc. v. Union Sugar Company* (1955) 45 Cal.2d 474, 482, quoting *Buckner v. Leon & Co.*, 204 Cal. 225 (emphasis added). “[T]he court may fill in missing terms by reference to the rest of the contract, extrinsic evidence and industry practice [Citations].” *Facebook, Inc. v. Pacific Northwest Software, Inc.* (2011) 640 F.3d 1034, 1038 (applying California law). “In the absence of express conditions, a court may look to custom and practice to determine incidental matters, so long as such matters do not alter or vary the terms of the agreement.” *Elite Show Services, Inc. v. Staffpro, Inc.* (2004) 119 Cal.App.4th 263, 269, citing *King v. Stanley* (1948) 32 Cal.2d 584, 588-589.

“[I]n determining whether the material factors in a contract are sufficiently certain for specific performance, *the modern trend of the law favors carrying out the parties’ intention through the enforcement of contracts and disfavors holding them unenforceable because of uncertainty* [citations omitted]. *The defense of uncertainty has validity only when the uncertainty or incompleteness of the contract prevents the court from knowing what to enforce* [citations omitted].” *Hennefer v. Butcher* (1986) 182 Cal.App. 3d 492, 500 (emphasis added). The essential terms of the construction loans obligation were expressly stated in these loan commitment letters. There is no reason that a court would be unable to enforce these obligations and in doing so it would be acting consistent with the weight of the law.

### III.

#### DOF’S UNDERGROUND POLICY IS CONTRARY TO STATE REGULATIONS

Regulations of an administrative agency validly adopted in accordance with the requirements of the APA have the binding force and effect of law. *Agricultural Labor relations Bd. v. Superior Court*, 16 Cal. 3d 392 (1976). The TCAC regulations cited in Section 2 of Background were enacted, in part, to carry out TCAC’s obligations under federal law governing the low-income housing credit program. Section 42 of the Internal Revenue Code describes TCAC’s obligations in administering the program. One of those obligations is to assure that the amount of tax credit awarded does not exceed the amount determined by TCAC to be necessary for the financial feasibility of the project. In making that determination, TCAC must consider “the sources and uses of funds and the total financing planned for the project.” *IRC 42(m)(2)(A),(B)*. TCAC’s determination must be made at the time of application for tax credits and must include a certification from the applicant as to the full extent of all Federal, State, and local subsidies which apply. *IRC 42(m)(2)(C)*.

The TCAC and CDLAC regulations clearly acknowledge that loan commitment letters are “firm” and “binding” commitments to the extent that they are only subject to conditions within the control of the applicant. In awarding tax credits for all of the four housing projects

referenced in the background, TCAC expressly acknowledged that the loan commitment letters for these projects evidenced “firm” and “binding” commitments, which could be relied upon by the housing developers, and their equity partners and institutional lenders. One must presume that these determinations were not made lightly by TCAC; rather, they reflect TCAC’s administrative obligation under federal law and its own regulations to carefully consider the evidence submitted in support of binding commitments for the project.

TCAC’s careful review of evidence of financing commitments also reflects the reality that California is allocated only a limited amount of federal tax credits annually and cannot make awards that exceed the State’s allocation. *IRC 42(h)(3)*. There could be serious repercussions if TCAC awarded those credits on the basis of unenforceable loan commitments. If a lender, including a public agency, had the ability to renege on its commitment, the projects would be at risk of not being implemented. At a minimum, this would result in a substantial delay until the credits could be recovered and reallocated by TCAC and, as a worst case, the State would face the possibility of having its credits recaptured by the federal government and redistributed among the other States. *IRC 42(h)(3)(D)*. Either outcome is clearly unacceptable in light of the overwhelming demand for affordable housing and the intense competition for these credits.

TCAC relies upon the enforceability of commitment letters to satisfy its federal obligations and to avoid delays or possible loss of scarce low-income housing credits. DOF’s refusal to acknowledge commitment letters as enforceable obligations pits its judgment against that of a state body with extensive experience and expertise in low-income housing project financing.

Additionally, the developers have relied upon the State’s administrative regulations and TCAC’s administrative procedures which accept public agency commitment letters as evidence of “firm” and “binding commitments”. Nothing in AB1x 26 authorizes the DOF to ignore this reality. And nothing in AB1x 26 authorizes the DOF to exempt an entire class of binding commitments merely because these commitments are in the form of a letter. To assert as such either demonstrates DOF’s inexperience with affordable housing transactions or a misguided attempt to divert tax increment and, as a result, expose the Successor Agency and the City to payment of substantial damages to the developers. Either way, the DOF has no legal basis to circumvent state regulations adopted in accordance with the APA.

#### IV.

#### DOF’S ACTIONS CONFLICT WITH AB1X 26

##### 1. AB1x 26 and the Definition of “Enforceable Obligation”

AB1x 26, including Part 1.8 and Part 1.85 of the Health & Safety Code, was chaptered on June 29, 2011. Part 1.8 provided for the suspension of RDA activities and the prohibition on new RDA debt. Part 1.8 became effective on the effective date of AB 1x 26, except as to the

portions temporarily suspended by the California Supreme Court in the *Matosantos* case.<sup>6</sup> Part 1.85 became effective on February 1, 2012, per the Supreme Court's order in the *Matosantos* case. Part 1.8 and Part 1.85 each contain a separate definition for "enforceable obligation."

"Enforceable obligation," as defined in Section 34167 of Part 1.8, is defined in pertinent part, as follows:

(d) For purposes of this part, "enforceable obligation" means any of the following:

(5) *Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.*

"Enforceable obligation," as defined in Section 34171(1) of Part 1.8, is defined in pertinent part, as follows:

(d) (1) "Enforceable obligation" means any of the following:

(E) Any legally binding and enforceable agreement or contract that is not otherwise void as violating the debt limit or public policy.

(2) *For purposes of this part, "enforceable obligation" does not include any agreements, contracts, or arrangements between the city, county, or city and county that created the redevelopment agency and the former redevelopment agency....*

(3) *Contracts or agreements between the former redevelopment agency and other public agencies, to perform services or provide funding for governmental or private services or capital projects outside of redevelopment project areas that do not provide benefit to the redevelopment project and thus were not properly authorized under Part 1 (commencing with Section 33000) shall be deemed void on the effective date of this part; provided, however, that such contracts or agreements for the provision of housing properly authorized under Part 1 (commencing with Section 33000) shall not be deemed void. (Emphasis added.)*

The definition of "enforceable obligation" in Part 1.8 thus differs from the definition of "enforceable obligation" in Part 1.85 in that the former definition does not exclude city-agency

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<sup>6</sup> *California Redevelopment Association v. Matosantos* (2011) 53 Cal. 4<sup>th</sup> 231.

agreements as an enforceable obligation, while the latter definition does, except under certain circumstances, including the provision of housing properly authorized under the CRL.

While Part 1.8 clearly prohibited *the RDA* from entering into any new contracts after the effective date of AB1x 26, it did not prohibit *the City* from exercising its rights under any pre-existing agreements with the RDA until February 1, 2012. Therefore, *the City* was not precluded from exercising all of its rights under the Master Cooperation Agreement until February 1, 2012. However, even after February 1, 2012, the DOF had no authorization to interfere with the City's implementation of the Master Cooperation Agreement for the provision of affordable housing given that Section 34171(d)(3) contains the qualification that "*contracts or agreements for the provision of housing properly authorized under [the CRL] shall not be deemed void.*"

The City's provision of affordable housing included the six construction loan agreements as well as the seventy-nine (79) tenant vouchers. DOF has no legal basis under AB1x 26 to deny the enforceability of these agreements merely because the City executed these agreements after June 27, 2011.

## V.

### **DOF'S ACTIONS WILL CAUSE IRREPARABLE HARM**

The harm caused by DOF's overreaching cannot be understated. Health and Safety Code section 34176(a)(2) provides that "[i]f the transferred asset is deemed not to be a housing asset as defined in subdivision (e), *it shall be returned to the successor agency ....*" Since the Set Aside Funds distributed to the four developers have already been expended for construction of affordable housing projects, the City's only means of recouping these funds would be to call the loan notes. Any attempt to call the notes would precipitate other adverse consequences, including foreclosure actions by the institutional lenders and loss of tax credits. The loss of tax credits, in turn, would cause these developers to breach their tax credit partnership agreements. The enforceability of the affordability covenants would then be undermined and the opportunity for affordable housing would be lost. In short, DOF's overreaching will result in litigation and wasted public resources in addition to all the harm imposed on the developers and their private and public financing partners.

Similarly, any attempt to recoup the housing rental subsidies from the owners of the properties housing the seventy-nine (79) tenants would only result in the evictions of these tenants and the resulting consequences of their being returned to the streets. There is simply no legal justification for this outcome.

September 25, 2012

Page 21

CONCLUSION

In closing, our office sends this letter to clearly delineate the City's position with respect to the DOF's rejection of the housing assets listed on Exhibit C of DOF's housing asset form. The issues raised in this letter are not intended to be an exhaustive list of the legal grounds for objecting to DOF's determinations. The City does not intend to waive any constitutional, statutory, legal, or equitable rights in lodging this written objection. We expressly reserve and continue to reserve any and all rights, privileges, and defenses available whether existing under law or equity

Thank you for your consideration,

  
MARSHA JONES MOUTRIE  
City Attorney

MJM/bcm

Enclosure

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