MEMO REGARDING LAS HACIENDAS SUBORDINATION AGREEMENT

BACKGROUND COMMUNITY HOUSINGWORKS & LAS HACIENDAS DEVELOPMENT

Community HousingWorks – Who We Are

Community HousingWorks is a highly respected 501(c)(3) nonprofit organization with over 35 years of experience in developing, rehabilitating, preserving, and operating affordable housing communities throughout California.

We own and operate over 4,500 affordable apartment units in nearly 20 cities across the state, including the City of Temecula. Our dedication and expertise have enabled us to sustain strong financial health, achieve high occupancy rates at our properties (averaging 99%), and secure partnerships that have helped over 9,000 households obtain quality affordable housing. We have an impeccable track record of upholding our compliance commitments, with no regulatory agreement defaults and no foreclosures.

The Development of Las Haciendas in the City of Temecula

In 2020, Community HousingWorks (CHW) identified a significant need for affordable housing in Temecula and partnered with the City to develop Las Haciendas, a 77-unit, 100% affordable housing community. We successfully completed the project earlier this year. The development has experienced overwhelming demand, resulting in fully leased units within a month of being placed in service and a waiting list of over 4,800 individuals.

There is a clear need for more affordable housing in the City of Temecula, and partnerships with developers like CHW are essential to meeting that need.

Financial Urgency to Convert to Permanent Financing

CHW did experience financial challenges in developing Las Haciendas, however. Delays caused by the General Contractor resulted in late completion of the project, leading to additional expenses, straining the project and CHW financially. The bulk of additional expenses relate to construction loan interest paid above and beyond what was budgeted, due to these delays. Furthermore, these contractor delays resulted in the loss of our favorable permanent interest rate, locked at construction loan close, but negated when the delays prevented us from meeting the specified closing deadline.

This meant that, in the face of budget increases (now exceeding $800,000, which has all been advanced to the project by CHW), we also found ourselves with a lower available permanent mortgage, based on the loss of our favorable interest rate. We were able to obtain a permanent commitment from NewPoint a Freddie Mac lender, which through favorable terms and underwriting, helped mitigate some of the financial impact to the project, allowing a permanent loan of approximately $5.45 million dollars, compared to $4.9 million with the initial lender after our rate lock expired.

However, we are now facing delays in closing the permanent financing, which means the excess construction interest costs continue to grow at a rate of over $150,000 a month. The City of Temecula's agreement to sign the subordination form acceptable to the senior lender is key to removing a substantial barrier to closing the permanent financing, enabling the project to move forward with financial stability.

THE ISSUE AT HAND

Subordination Agreement Considerations

The City's loan must be subordinated to the senior lender, in this case, Freddie Mac. Typically, a local regulatory agreement would also be subordinated, but the City of Temecula mandates that its Regulatory Agreement retains a priority position. Fortunately, Freddie Mac, as senior lender, is able to accommodate this requirement, allowing the City's Regulatory Agreement to remain in senior position, only subordinating the City loan. However, certain terms of the subordination required by Freddie Mac are different than what we had in place at the time of construction loan close, necessitating City approval.

Under the proposed subordination agreement approved by Freddie Mac, the loan is subordinated while the Regulatory Agreement remains unaffected. If a Regulatory Agreement default occurs, the City must wait for a 90-day period and obtain consent from the senior lender before initiating foreclosure or loan acceleration proceedings related to their subordinate loan, which is cross-defaulted with the Regulatory Agreement. Importantly, all other remedies provided within the Regulatory Agreement are still available to the City without the need for senior lender approval.

The City of Temecula, as the subordinate lender, wished to maintain the right to foreclose or accelerate their subordinate loan in the event of a Regulatory Agreement default even if the senior lender does not consent. This requirement conflicts with Freddie Mac's senior lender position, as it could potentially compromise the priority of their lien position. Consequently, Freddie Mac is unable to approve any agreement that includes such a provision.

While the subordination agreement signed with the construction lender at the beginning of the project included a provision that better aligned with the City's request, it is uncertain whether the previous permanent lender would have required adjustments to those terms. Extensive efforts by Community HousingWorks, our attorneys, and NewPoint attorneys were dedicated to finding a precedent where Freddie Mac agreed to similar conditions, but no such examples were found. Moreover, even Wells Fargo, the construction lender in this deal, has indicated that they can no longer agree to the terms of the previous subordination, particularly the provision allowing a junior lender to accelerate or foreclose on their loan after a stand-still period due to a Regulatory Agreement default (unless such acceleration is agreed to by the senior lender). Thus, this is no longer commercially available option.

By approving the Freddie Mac form of subordination, the Las Haciendas project will be able to secure permanent financing, which will alleviate the mounting cost burden caused by rapidly accumulating construction loan interest. Additionally, this will help prevent a foreclosure on the construction loan, which could render the Regulatory Agreement void. The Freddie Mac subordination form is still substantially similar to the terms offered by the previous lender, as illustrated in the chart below. Furthermore, the risk of a Regulatory Agreement default is minimal, as explained in greater detail later in this memo.

Comparison of Freddie Mac Subordination Agreement and Subordination Previously Approved by the City

	Freddie w/ Reg Agrmnt Rider	**Wells/CCRC subordination**
Loan Subordinated?	Yes	Yes
Reg Agreement is Subordinate Loan Doc?	No	No
Upon foreclosure, Reg Agreement:	SURVIVES (prior to Senior Loan)	SURVIVES (prior to Senior Loan)
Regulatory Agreement Default		
Remedies provided for in Reg Agreement:		
Equitable Remedies (performance)		
Available?	Yes	Yes
Require Standstill (60 or 90 day duration)?	No Standstill Available immediately	No Standstill Available immediately
Require Senior Lender Consent?	No	No
Financial Remedies (Foreclosure, loan acceleration)		
Available?	Yes, at sole discretion of Senior Lender	Yes
Require Standstill (60 or 90 day duration)?	Yes	Yes
Require Senior Lender Consent?	Yes, Senior Lender's sole discretion	NO -- only during standstill period, after that City may exercise

Ramifications of a Regulatory Agreement Default on Las Haciendas

In the event of a Regulatory Agreement default, CHW would simultaneously be in default with both Freddie Mac (the senior lender) and the City of Temecula. This situation would entitle Freddie Mac to exercise all rights and remedies under the Senior Loan, including the right to foreclose. In the event the Senior Lender foreclosed, the City Loan would be extinguished, but the City Regulatory Agreement would remain in effect.

The Regulatory Agreement will survive foreclosure regardless and ultimately, a new operator would need to come in and bring the property back into compliance. However, such a scenario is highly improbable, considering CHW's 36-year history of managing high-quality affordable housing and our unwavering commitment to compliance. Furthermore, CHW has a strong motivation to avoid defaulting on the Regulatory Agreement to avert the potential repercussions outlined below.

Long Term Implications – Additional Considerations

Apart from averting adverse consequences from both the City of Temecula and Freddie Mac, it is crucial for CHW to operate Las Haciendas in compliance with the Regulatory Agreement for the sake of our mission and the overall viability of our nonprofit organization.

A default on the Regulatory Agreement would have severe, lasting repercussions for CHW, jeopardizing relationships at multiple levels and critically impacting our ability to continue our work. With over 30 tax credit allocations from the California Tax Credit Allocation Committee (TCAC), such a default would damage CHW's standing with TCAC, severely hindering our ability to develop affordable housing in California. Additionally, we would likely be placed on a “Do-Not-Do-Business-With List” by Freddie Mac, further limiting our future financing options. As a mission-driven nonprofit developer, we would never risk our ability to fulfill our commitment to affordable housing by allowing a Regulatory Agreement default to occur.

Mission Alignment

TCAC, Freddie Mac, and the City of Temecula all share a common objective of creating and preserving quality affordable housing in partnership with owners and operators like CHW who will uphold the Regulatory Agreement. Each stakeholder is deeply invested in ensuring strict adherence to their affordable housing objectives. The presence of multiple stakeholders ensures a "belt and suspenders" approach to Regulatory Agreement compliance, where defaulting with one regulator effectively means defaulting with all.

In conclusion, if a Regulatory Agreement default occurred and remained uncured, this would lead to foreclosure by Freddie Mac and the termination of the City's subordinate debt, regardless of whether there were a negotiated right by the City to force Freddie Mac to foreclose. Such a default would have severe financial and reputational consequences for CHW's mission to develop affordable housing. Ultimately, CHW, the City of Temecula, and Freddie Mac are united in their commitment to upholding the Regulatory Agreement and maintaining a strong partnership to provide quality affordable housing.