State of California
BUSINESS, CONSUMER SERVICES AND HOUSING AGENCY

Gavin Newsom, Governor
Lourdes M. Castro Ramírez, Secretary

Date: December 20, 2021

To: Fiona Ma, CPA
California State Treasurer

From: Lourdes M. Castro Ramírez, MA
Secretary

CC: Betty T. Yee, CA State Controller
Keely Bosler, Director, Department of Finance

Re: California Debt Limit Allocation Committee (CDLAC)

On behalf of Governor Gavin Newsom's Administration, I thank you for your commitment to ensuring that the state housing finance system supports the state's housing goals. We appreciate the data-driven focus and your partnership on this effort to expand affordable housing opportunities. You will recall that in November, I shared the Administration's housing priorities along with recommendations to inform the 2022 CDLAC regulation changes. The recommendations build on the progress we have made collectively to expand affordable housing production. Building on that discussion, this memo includes analysis on the tie-breaker and the state's proposal for the funding pools and set-asides.

Tie-Breaker Analysis

As mentioned at the CDLAC meeting held on December 8th, the Housing and Community Development Department (HCD) analyzed the tie-breaker proposal using existing 2021 awardee data. We are pleased to confirm, that the tie-breaker designed by the Committee seems to elegantly balance state policy priorities, while not overemphasizing any single public benefit measured in the tie-breaker. While no model can truly predict what might occur with a new set of unique projects entering the bond competition, modeling based on 2021 awardees shows promising outcomes.

We found that potential regional inequities are substantially equalized because, at the County level, costs generally correlate with Fair Market Rent (FMR), so numerator and denominator balance each other. The Committee's elected use of a 25% weight and no-cap in applying the statewide basis delta adjuster to bond requests in the denominator seems to be fairly good at equalizing regional effects. For example, San Francisco, Fresno, and Butte County all fared similarly in our model.

We also found that deep affordability is consistently rewarded without being determinative. Tie-breaker competitors had to be cost-efficient in their bond request – higher than average bond requests were rarely winners, and even average bond requests were substantially disadvantaged as compared to modeled projects with bond requests 25% lower than their county average. The state priority on deep affordability does not drive to an unacceptably inefficient use of bonds.

This finding is consistent with what we saw in 2021 awardees, and with what we know drives costs. Rather than Area Median Income (AMI) alone, many interrelated factors can contribute to higher bond requests including construction type, infill sites, proximity to amenities, county, hiring and wage requirements, high-opportunity neighborhoods, high-quality construction and services, and delays in securing financing. For instance, Beacon Landing, a building awarded this year in Los Angeles with a 30% AMI average affordability, had a substantially lower cost per unit ($503,000) than did Osgood Apartments, awarded in Alameda County, with a 59.8% average AMI and a cost per unit of $673,000.

Other findings from initial modeling offer further evidence that the tie-breaker has been successfully designed and weighted.

- High scores result from the following combination of features (scores at 19 to 35 points)
  - Average AMI at 30-45%
  - Moderate or low bond request (not high)
  - Moderate or maximum Transit & Walkability scores (not low)
  - At least 20% ELI units
- The rare and exceptional projects that have 30%-40% AMI Average, maximum locational benefits and low bond requests consistently win. These are the projects we all agree are providing maximum public benefit for most efficient use of resources.
- Projects do seem to have difficulty if they rely heavily on any single scoring criteria to the detriment of others.
- To the extent that a project would need a higher bond request to accommodate these public benefits, this would make them uncompetitive (scores drop to 10-17 points.)
- To the extent that a project is in a low-transit/walkability location it becomes uncompetitive (scores drop to 15-18 points) *unless* it is in a high resource area *and* has a low-bond request.
- To the extent that average affordability goes above 45% AMI, and ELI drops below 20%, it becomes uncompetitive (scores drop to 10-18 points)
- To the extent that high FMR counties are more competitive, these are generally counties with the most severe affordable housing shortages. For instance, Santa Clara County and Orange County fared well in our model.

In addition to these tie-breaker outcomes, due to the Affirmatively Furthering Fair Housing (AFFH) point-category, we expect high/highest resource area projects to have multiple paths to success since there will be a limited pool of competitors in 2022. This may become less true in 2023 as more high/highest opportunity sites enter the competition.

As we expected, the tie-breaker requires applicants to score favorably across all elements (affordability, population, locational benefits, and cost-efficiency). Projects seem to have difficulty if they rely heavily on any single scoring criteria to the detriment of others. This demonstrates that the tie-breaker encourages projects to integrate the Administration's priorities while addressing housing need throughout the state.

Pool and Set-Aside Recommendations

We are pleased that the Committee was successful in building an innovative public-benefits tie-breaker without jeopardizing geographic equity – a concern we all share. The Administration does not suggest any major pool modifications this year. Until we see the results of the tie-breaker, we have no reason to alter the intentional pool allocations established for the 2021 cycle. Additionally, the Governor and Legislature adopted a 2-year historic housing budget, and maintaining consistency in the pool and set-aside allocations will help effectively deploy the state resources which are dedicated to housing. Our recommendations for minor, definitional, and technical fixes to the pools and set-asides are summarized below.

CDLAC 2021 Allocations & 2022 Proposal

2021 Total California PAB Volume Cap	$4,330,488,580
Exempt Facilities / Other	(600,000,000)
QRRP PAB Volume Cap (Multifamily)	**$3,730,488,580**

	2021 Percent	2021 Allocation	2022 Proposal	2022 Estimate
NON-GEOGRAPHIC POOLS + SET-ASIDES	**60% (of QRRP)**	**$2,238,293,148**	**60%**	**$2,238,293,148**
Pools				
Rural (New Construction)	5%	$111,914,657	6%	$134,297,589
Preservation	14%	313,361,041	15%	$335,743,972
Other Rehabilitation	1%	22,382,931	1%	$22,382,931
BIPOC	5%	111,914,657	5%	$111,914,657
New Construction Set-Asides				
Homeless	25%	559,573,287	23%	$514,807,424
ELI/VLI	30%	671,487,944	27%	$604,339,150
State Funded Mixed Income	20%	447,658,630	23%	$514,807,424
Total Pools and Set-Asides (Non-Geographic)	**100%**	**$2,238,293,148**	**100%**	**$2,238,293,148**

	2021 Percent	2021 Allocation	2022 Proposal	2022 Estimate
GEOGRAPHIC REGIONS (New Construction)	**40% (of QRRP)**	**$1,492,195,432**	**40%**	**$1,492,195,432**
Coastal Region	21%	$313,361,041		
City of Los Angeles	18%	$268,595,178		
Balance of LA County	17%	$253,673,223		
Bay Area Region	17%	$253,673,223		
Inland Region	17%	$253,673,223		
Northern Region	10%	$149,219,543		
Total Geographic Regions	**100%**	**$1,492,195,432**	**100%**	**$1,492,195,432**

1. To ensure that communities across all areas of the state benefit from affordable housing sited in high/highest opportunity locations, AFFH projects awarded within the 50% soft cap should be equitably distributed among the geographic pools and other non-geographic pools and set-asides.

   Rationale: Currently, funding of projects occurs roughly sequentially, beginning with the non-geographic pools and set-asides. Under this methodology, the AFFH soft-cap could be met before projects in all geographic regions are evaluated for funding, and possibly even before the MIP projects are funded. A concentration of high/highest opportunity projects in only certain pools or set-asides would be counter to AFFH goals.

2. Group high-FMR Counties with other high-FMR Counties, and low FMR-Counties with other low FMR-Counties for extra security against any unforeseen undue advantage to high-FMR Counties. Bond allocation should follow County re-alignment in exact proportion, without rewarding or disadvantaging any region due to the changes of Counties assigned to each region.

   Rationale: While we do not have evidence of a problem – models do not show a substantial advantage to high-FMR locations, this is an easy way to ensure extra security against any unintended geographic effects.

3. Retain the current division between Pools, Set-asides, and Geographic regions, with 60% of bond allocation to set-asides and 40% of bond allocation to geographic regions.

   Rationale: We need to see results from the new tie-breaker before layering in further changes into the competition. This will allow us to more accurately assess and refine the tie-breaker.

   We are, however, aware of proposals to increase geographic allocations in order to hedge against possible geographic equity impacts of the new tie-breaker. We do not favor this solution because it is at odds with the Administration's policy priorities of ending homelessness and boosting construction where housing supply is shortest (ELI/VLI units). Importantly, this change would also disadvantage HCD-funded projects. It remains of utmost importance to align state finance agency awards so that projects can break ground more quickly and without excess holding costs.

   After all the California Housing Accelerator awards are made, we project there will be approximately 112 projects in the bond pipeline from HCD for 2022, for a total bond demand of about $2.5 billion.

   Using the 50% bond test and an assumed 50% success rate in the bond competition, we project that 60-65 HCD projects could remain unfunded after the three 2022 competitions, for a total unmet bond demand of $1.4 billion. If the 25% test is enacted, this excess demand significantly diminishes, but it does not entirely go away. These projects are shovel-ready, they are funded by voter- and legislature-approved resources, and they become more costly with every week of construction delays. The new tie-breaker does not solve this challenge, thus, we recommend retaining the existing balance between geographic pools and set-asides.

4. To the extent feasible under IRS regulations, allocate any unused bonds from other

pools and set-asides, as well as any bond award reversions, remainders, and carry-forwards to the ELI/VLI Set-Aside, as has been the practice this year.

Rationale: Across all regions of the state, the largest gap in supply is for housing affordable to ELI/VLI households. Furthermore, production numbers reported through the Housing Element process document continual under-production in these categories. We recommend that unused bonds from other pools be allocated to the ELI/VLI Set-Aside in the final round of the year or, ideally, at the end of each round.

5. Increase allocation to the Mixed Income Program (MIP) pool and the Preservation pool for 2022, reducing the ELI/VLI and Homelessness pools.

   Rationale: The Administration has consistently supported the continuum of housing and income levels. While the greatest need and least production is within the ELI/VLI pools, mixed income construction still falls short of demand. Given the demand and efficiency in the California Housing Finance Agency programs specifically, it is important that we continue to grow the supply of mixed-income housing.

6. Eliminate the 2021 sunset date for a key ELI/VLI set-aside requirement due to sunset in 2021. This would continue requirements for an average AMI of 50% or below and either an award from HCD or a local award.

7. Change prioritization within the Homeless Set-Aside from 100% Homeless to 49% Homeless.

   Rationale: To promote integration, HCD programs prioritize projects serving no more than 49% homeless individuals.

8. Broaden the definition of Homeless by including the entirety of TCAC's definition, including categories "2", "3" and "4" which encompass the Federal definition of Homelessness.

   Rationale: The definition of homelessness used for this pool is narrower than either TCAC or HCD use in other programs and unnecessarily narrows the type of homeless populations we prioritize for state funding. Varied definitions create implementation challenges for sponsors. Additionally, growing acknowledgement that not all homeless individuals need intensive services or Permanent Supportive Housing further validates an expanded Homeless definition. Including TCAC categories "2", "3" and "4" expands the definition to homeless youth, individuals and families fleeing domestic violence, and individuals imminently losing their nighttime residence. The federal definitions used in Homekey are similar.

9. Refine the Preservation and Other Rehabilitation Point Category to close loopholes and maximize public benefit. In addition to these improvements in the CDLAC system, encourage exploration of how to create more opportunities for preservation and rehabilitation projects across State Housing Finance Agencies. For instance, the 2021-22 state budget provided $300 million for a Preservation program administered by HCD to extend affordability on existing projects. Additionally, CalHFA's recycled bond program can support the preservation of existing affordable and NOAH properties since recycled bonds provide a new source of low-cost, tax-exempt debt financing.

Rationale: Although the Preservation Pool was already refined in the last cycle of regulatory revisions, one small loophole should be addressed. Currently, projects with rental assistance contracts that are not truly at-risk can compete favorably in this limited pool. Projects with rental assistance contracts that are not truly at-risk for conversion should no longer be eligible for Preservation funds.

Acquisition and rehabilitation of "Naturally Occurring Affordable Housing (NOAH)" can offer a triple benefit to the state: (1) cost efficiency, (2) displacement prevention, and (3) creation of quality units with lasting affordability. However, there have been particular challenges with defining and selecting NOAH rehab projects to advance these goals. We should add a NOAH pool or modify the "Other Rehabilitation" project category to focus on converting NOAH into dignified housing with lasting affordability. To ensure NOAH projects offer substantial public benefit, eligibility criteria and points should:

- Require a minimum level of rehabilitation
- Prioritize projects with average income targeting at 50% AMI or below
- Prohibit displacement of more than 10% of existing tenants
- Restrict developer fees and equity take-outs

Additionally, NOAH projects should be eligible for High/Highest Opportunity points. Staff might also consider measuring Rent Savings Benefit for NOAH projects against current rents rather than FMR.

NOTE: If NOAH projects and Preservation projects are both carefully defined and prioritized, the proposed two or three pool structure could be combined into one pool.

10. Limit the funds available in each round for supplemental bond requests.

Rationale: Currently, developers can return, post-award, to CDLAC and ask for a small supplemental bond allocation in order to meet their 50% test if their budgets have increased. With this system, they have an incentive to enter the competition with an under-sized bond request to enhance their competitiveness. This is unfair to those applicants who right-size their budget and, if too many developers take this tactic, it could diminish bonds available for new awards. A proposed fix is to have a limited pot available in each round for these supplemental requests. We are also open to any other proposed solutions to this challenge.

Point Category Changes

In our prior technical memo, there were several recommendations that have not yet been discussed at the Committee level. Some of these are of a minor and technical nature that do not warrant committee attention. These can be resolved at the staff level without requiring debate. Since we have mentioned these in the past, they are included below to ensure they are not lost in our fast-paced policy environment.

1. High/Highest Resource Area projects must earn a minimum threshold of site amenity points.

   Rationale: Site amenity points measure quality-of-life necessities and conveniences for residents that are not captured by the Opportunity Indicators. Some of these necessities are particularly important for individuals without cars, who are likely to be housed in permanent supportive housing. However, in order to not excessively limit the number of viable High and Highest Opportunity sites, we recommend a lower threshold of site amenity points. For instance, High/Highest Opportunity applicants could receive a bonus of three site amenity points or be required to earn seven out of ten amenity points.

2. High/Highest Resource Area points will be made available to the following project-types and construction types:
   - New Construction
   - Large Family, Special Needs, SRO, Acquisition-Rehabilitation
   - NOAH projects

   Rationale: We must continue to rebalance the portfolio for all target populations and avoid further concentration of low-income singles, special needs populations, individuals experiencing homelessness, and youth. Thus, we recommend expanding the types of projects incentivized to locate in high/highest resource areas. Only two types of applicants would be ineligible for AFFH High/Highest Opportunity Area points: Preservation projects and Senior projects. Unfortunately, due to NIMBY opposition, Senior projects tend to be those easiest to build in high opportunity locations. Allowing Senior projects to access High/Highest Opportunity Area points could reinforce the pattern of senior-only affordable housing in more exclusive neighborhoods. Existing affordable housing is largely located in low resource and high poverty areas. If the state de-prioritized rehabilitation of these buildings by virtue of their location, it would repeat disinvestment patterns that have been so detrimental to disadvantaged communities.

3. The 9-point AFFH category should be simplified to apply to any project with public funds of at least $1 million committed on or before 6/30/22.

   Rationale: Projects that are already in a state or local "pipeline" will become more expensive the longer they must wait in the queue for a bond award. Even as state and local funders are becoming better aligned with CDLAC and TCAC on priorities, cost containment requires prioritization of the existing pipeline. Additionally, CalHFA and HCD projects have, through the selection process, been confirmed to be advancing the Administration's AFFH priorities.

4. All projects earning 8 to10 points under the AFFH point category must provide, at minimum: 10% units at or below 30% AMI *and* additional 10% at or below 50% AMI.

   Rationale: Data demonstrate that the most severe housing shortfall is for ELI and VLI individuals and families. For this reason, and to encourage de-concentration of poverty, some level of deep affordability should be expected of all projects receiving substantial State investment.

Thank you again for the opportunity to advance the state's recommendations with data, analysis and an allocation proposal as the Committee deliberates on the 2022 CDLAC Regulations. I appreciate the ongoing collaboration between the Administration, the Treasurer, and the Controller in addressing state housing goals.