THE CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE
December 12, 2018

Consideration of Appeal of the Assessment of Negative Points
(Agenda Item No. 7)

ACTION:
Consider the appeal of the assessment of Negative Points on 700 Block of K Apartments.

BACKGROUND:
Pursuant to Section 5230(o)(1)(C), negative points are "...deducted for each failure to spend the proceeds of Bonds issued pursuant to an Allocation in full, or in accordance with the terms and conditions of the Committee Resolution, unless it can be demonstrated that the failure was unforeseen and entirely outside the Project Sponsor's control, the amount not spent is not material, or the deviation from the terms and conditions of the Committee Resolution is not material."

700 Block of K Apartments (14-309)
The 700 Block of K Apartments (the Project) received a Bond Allocation from CDLAC on December 10, 2014. Bonds were issued in December 2014 and the Performance Deposit was released. To qualify for an allocation of 4% low-income housing tax credits, 50% or more of the Project's eligible development costs must be funded by bonds during construction. This is commonly referred to as the "50% Test". The bonds for the Project were structured as Draw-Down Bonds (the Bonds) which means that bond proceeds are drawn from the bondholder and disbursed over time. Pursuant to the Internal Revenue Service Notice 2011-63, Draw-Down Bonds must be fully disbursed by the end of the year in which the third anniversary of the bond issuance occurred. In this case, that date was December 31, 2017. Any amount of Bonds drawn down after the three-year period are deemed not issued, pursuant to the volume cap obtained in connection with the Bonds, and are not considered tax- exempt private activity bonds for 50% Test purposes.

The project experienced numerous delays. As a result, approximately $14.5 million of the Bonds were drawn prior to December 31, 2017 resulting in the termination of the tax exemption on the balance of the $7.7 million remaining bond balance. The result of the termination of the tax exemption of the remaining bond balance of $7.7 million was that the Project did not meet the 50% Test which precludes the Project from receiving 4% Tax Credits for the 84 affordable housing units in this project. If the loss of the 4% Tax Credits had not been remedied, the Project would have forfeited $8,900,000 in tax credit investor equity collapsing the financing structure and resulting in the loss of 84 affordable housing units.

The only available remedy was to issue new tax-exempt private activity bonds in 2018, pursuant to a new allocation of private activity bond volume cap from CDLAC, to meet the 50% Test. CDLAC staff recommended that a new allocation of tax-exempt bonds be approved by the Committee at the September 19, 2018 Committee meeting. The allocation was approved and the new bonds were issued in November, 2018 retiring the old Bonds.

Despite the request by CDLAC staff to issue $22 million of new bond allocation, staff recognized that the failure to meet the 50% Test resulted in the misuse of over $22 million in private activity bond allocation. In accordance with CDLAC Regulations, Section 5230(o)(1)(C), CDLAC staff assessed ten negative points against the Project Sponsor for a period of three (3) calendar years (10 points each year) effective September 12, 2018. Staff deducted 10 points from the request for new allocation and notified the sponsor that the negative point's deduction would be assessed against their projects (up to 10 points each year) for the next two calendar years.

The Project Sponsor appealed the negative points on November 7, 2018, almost 60 days after the letter from CDLAC assessing negative points. The Project Sponsor does not contest that there was a failure to spend the proceeds of Bonds issued pursuant to an Allocation in full, or in accordance with the terms and conditions of the Committee Resolution; that the amount not spent was material, and that the deviation from the terms and conditions of the Committee Resolution was material. The Project Sponsor contends that the failure was unforeseen and entirely outside the control of the Project Sponsor and they point primarily to weather conditions, the federal tax reform act and the untimely passing of Ali Youssefi. CDLAC staff are saddened by the untimely passing of Ali Youssefi. CDLAC staff acknowledged that many projects were impacted by the uncertainty caused by the federal tax reform act. CDLAC staff also understands that weather can impact development, but that is why construction contracts contain provisions for delays of various sorts. CDLAC staff determined that the Project Sponsor, 700 Block Investors, L.P., was responsible for the timely disbursement of bond proceeds and meeting the federal deadline to preserve the tax-exempt status of the bonds. In that execution, the Project Sponsor failed and that function was entirely within the Project Sponsor's control. The failure to draw down on bonds sufficiently to meet the 50% Test was entirely foreseeable and within the control of the Project Sponsor.

To preserve the mixed-use housing at 700 Block Apartments, CDLAC allocated an additional $22,186,052 in bond allocation on September 19, 2018 to replace the exact same amount of bond allocation that was initially awarded on December 10, 2014. That additional $22 million in bond allocation will not result in the construction or rehabilitation of a single additional housing unit in California. Additionally, CDLAC has approximately $22 million less available in 2018 statewide carryforward to allocate towards the preservation or construction of much needed housing in California.

RECOMMENDATION:

In light of the circumstances described above, staff recommends a denial of the Appeal of Negative Points for the 700 Block of K Apartments.

Prepared by Laura Whittall-Scherfee