Building for California’s Future

CDLAC & CTCAC Regulation Revision Workshops June 14 - 28

Agenda

1. Provide an overview of CDLAC and CTCAC
2. Provide an overview of the Treasurer’s goals
3. Present proposed regulation changes
   - Solicit feedback on proposals
4. Solicit additional ideas for achieving goals

CA Debt Limit Allocation Committee (CDLAC)

- State agency that allocates tax-exempt bond authority to affordable housing projects and other forms of state infrastructure
- Tax-exempt bonds are required for affordable housing projects to obtaining 4% tax credits
- Tax-exempt bonds cannot be utilized with 9% tax credits to finance a single project

Current Environment

- Given the priorities of the administration, demand for multi-family housing tax-exempt bond allocation is expected to increase
- As of May 2019, 65% of Carryforward and 16% of 2019 Volume Cap has been used
- Due to the federally prescribed ceiling on tax-exempt private activity bonds, CDLAC Allocation Rounds have the potential of turning competitive in 2020 or 2021

Regulatory Focus Areas

- Readiness – Extensions are on the rise, causing delays and potential obstruction of housing production
- Allocation limits by unit – Regional analysis will need to be evaluated
- Updates to scoring, point thresholds, and tiebreaker
- Complete application – Review minimum requirements
- CDLAC TCAC regulation alignment

CA Tax Credit Allocation Committee (CTCAC)

- State agency that allocates 4% tax credits, 9% tax credits, and state tax credits
- 4% tax credits finance affordable housing that serves households earning 20%-80% of AMI, averaging no greater than 59%
- 9% tax credits finance housing for 20%-80% AMI households, averaging no more than 50%
- State credits are currently paired with special needs projects and projects that don’t receive the federal basis boost

Overview of Goals

- Increase housing production
- Contain development costs
- Spur new technology
- Increase opportunity for women and people of color
- Empower individuals in distressed communities
- Build wealth for all Californians

4% Projects Leveraging Conventional Debt

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<u>Problem:</u>

Requiring 10% of units to be at 50% AMI or below and requiring projects to average 59% AMI does not take full advantage of income averaging

- Reduces supportable conventional debt
- Increases government subsidy per unit
- Causes marginal projects to be infeasible
- Decreases housing production

4% Projects Leveraging Conventional Debt

Background:

- The 10% at 50% AMI requirement has been a longstanding means of achieving deeper affordability
- Almost all other state housing programs require deep levels of affordability and or special needs populations: the 9% program, MHP, AHSC, etc.
- No state housing programs are focused primarily on production

4% Projects Leveraging Conventional Debt

Initial Suggestions Received:

- CDLAC: Remove the 10% at 50% AMI requirement
- CTCAC: Remove the 10% at 50% AMI requirement for 4% projects
- CTCAC: Remove the requirement for income averaging projects to average 59% AMI

4% Projects Leveraging Conventional Debt

Pros and Cons:

- In a competitive environment, the projects with the deeper need for affordable housing may be overlooked
- Will increase supportable debt by ~1.5% and in turn increase production
- Will make some marginal deals feasible
- Will compliment the proposed $500m state credits in making 4% projects feasible without gap financing
- Will increase the average level of affordability from 59% to 60% of AMI

Immediate 9% Tiebreaker Improvements

<u>Problem:</u>
The primary driver of 9% awards is the first ratio of the tiebreaker, which calls for a high percentage of public funds/soft funds, which incentivizes smaller projects

- Small projects suffer from diseconomies of scale, thereby having higher cost per unit and less conventional financing
- Incentivizes public agencies to commit resources to 9% projects instead of 4% projects which need gap financing
- Incentivizes developers to reduce total units or phase projects to score better

Immediate 9% Tiebreaker Improvements

Background:

- In response to consistent feedback about this problem, TCAC incorporated the Size Factor into the tiebreaker
- While the Size Factor has made a noticeable difference, there remains a residual incentive to reduce project size while holding public funding constant

Immediate 9% Tiebreaker Improvements

<u>Initial Suggestions Received:</u>

- Amplify the effect of the Size Factor to neutralize the remaining incentive to reduce units to improve scoring

Immediate 9% Tiebreaker Improvements

Pros and Cons:

- Will remove the incentive to reduce unit count and remove the disincentive to increase unit count
- Will signal to the development community that building at efficient scales is important to the state
- Will remove the inherent advantage currently afforded smaller projects

Immediate 9% Tiebreaker Improvements

Problem:

The weight given to the second ratio of the 9% tiebreaker makes credit efficiency a de minimis factor in comparison to the heavily weighted public funding ratio

- Developers don't significantly improve their score by containing costs or reducing their credit request, both of which entail taking on additional risk
- Projects that produce more units using less credits are ranked lower than less efficient projects using more government resources

Immediate 9% Tiebreaker Improvements

<u>Background:</u>

- When the current tiebreaker was originally implemented the first and second ratios (public funding and credit efficiency) were equally weighted
- Shortly thereafter the second ratio (credit efficiency) was divided by three to prevent a certain method of gaming the tiebreaker
- Since there are numerous methods to game the tiebreaker regulations were added to penalize applicants that do not maintain their tiebreaker through placed-in-service

Immediate 9% Tiebreaker Improvements

Initial Suggestions Received:

- Divide the second ratio by 2 (instead of 3), thereby rewarding credit efficient applicants

Immediate 9% Tiebreaker Improvements

<u>Pros and Cons:</u>

- Will incentivize designing more efficient projects that require less tax credits to develop
- Will incentivize using innovative technologies that lower construction cost such as modular construction
- May partially reintroduce one method of gaming the tiebreaker

Immediate 9% Tiebreaker Improvements

<u>Problem:</u>
Projects required to forego state credits instead of federal credits are placed at an unfair disadvantage

- Applicants forego 9% federal credits, voluntarily excluding basis, to improve their tiebreaker
- While 9% federal credits and state credits are both scarce resources, foregoing state credits doesn't get counted in the tiebreaker

Immediate 9% Tiebreaker Improvements

Background:

- A handful of regulations have been adopted in the past few years to curtail the overallocation of state credits
- Not intending to impact 9% competitiveness, one such regulation prohibited 9% projects with state credits from voluntarily excluding federal basis

Immediate 9% Tiebreaker Improvements

<u>Initial Suggestions Received:</u>

- Subtract the value of foregone state credits from non-special needs applicant's requested unadjusted eligible basis in the tiebreaker

Immediate 9% Tiebreaker Improvements

Pros and Cons:

- Will allow 9% projects with state credits to compete on a level playing field with other projects
- Will keep the intent of reducing state credit overallocation intact

Delayed 9% Tiebreaker Structure Redesign

Problem:

Since redevelopment agencies were abolished, the 9% tiebreaker has promoted smaller projects that are inefficient and production has steadily declined

- The original premise of the tiebreaker—motivate local agencies to invest their abundant resource—is no longer valid
- The current tiebreaker is ambivalent to total project costs and provides little to no incentive to build efficient product or build at efficient scales

Delayed 9% Tiebreaker Structure Redesign

<u>Background:</u>

- The current tiebreaker was designed about 12 years ago
- The current tiebreaker is not easily adjusted as its many factors don’t interact cohesively
- TCAC held public forums in 2018 seeking feedback on redesigning the tiebreaker, where 82% of attendees agreed the tiebreaker should be redesigned to one that measures return on investment

Delayed 9% Tiebreaker Structure Redesign

Initial Suggestions Received:

- Codify a robust tiebreaker that measures return on investment for delayed implementation in 2021
- Make the fundamental measure:
  Units Produced / Credits Requested
- Include multiplicative factors that account for added public benefits and use additive adjusters that account for inherent differences in cost

Delayed 9% Tiebreaker Structure Redesign

3/A

<u>Pros and Cons:</u>

- Will incentivize building larger projects
- Will incentivize requesting less tax credits
- Will spur developer creativity and promote the use of innovative technologies
- Will reduce award predictability for a season
- Will dilute the influence local agencies have to “vote with their dollars”

Delayed 9% Tiebreaker Multipliers

Problem:

A production oriented tiebreaker that measures return on investment in Units Produced would fail to account for the public benefits derived from empowerment activities

- Locating family projects in high opportunity areas would be disincentivized
- There would be no incentive to empower individuals in distressed communities or help low-income households build wealth

Delayed 9% Tiebreaker Multipliers

<u>Background:</u>

- TCAC and HCD have spent the last few years designing and implementing incentives for developers to build family projects in high opportunity areas, which result in improved social and economic outcomes for children
- Since 9% applicants typically score maximum points, they serve more as thresholds than incentives, thereby requiring incentives to be incorporated into the tiebreaker

Delayed 9% Tiebreaker Multipliers

<u>Initial Suggestions Received:</u>

- Discount the tiebreaker [by 50%] for non-at-risk-resyndications that typically require half as many credits
- Amplify the tiebreaker [by 10%] for family projects in high opportunity areas
- Amplify the tiebreaker [by 2%-3%] for projects that include (a) eventual home ownership components, (b) empowering individuals in distressed communities, and or (c) reserving 10% of units for homeless households referred by coordinated entry systems

Delayed 9% Tiebreaker Multipliers

<u>Pros and Cons:</u>

- Will allow new construction projects to compete on a level playing field with rehabs that require less credits
- Will provide an incentive to incorporate certain empowerment activities into projects
- Will produce more impactful outcomes for the households we serve
- Will require definitions for concepts such as empowerment and distressed communities, which may include subjectivity

Delayed 9% Tiebreaker Adjusters

<u>Problem:</u>
A production oriented tiebreaker that measures return on investment using Credits Requested would disadvantage project types and locations that inherently cost more to develop

- Projects with more bedrooms and more square footage would be disadvantaged
- Infill projects, prevailing wage projects, and permanent supportive housing projects would be disadvantaged

Delayed 9% Tiebreaker Adjusters

Background:

- Certain project types and project locations cost more to develop than others yet they are equally important in meeting the state's housing needs
- Based on the inclusion of federal or state funding, certain projects are required to pay prevailing wages, which increases total project costs and the need for tax credits
- Committing to provide supportive services to special needs households limits a project's access to conventional debt, which increases its need for tax credits

Delayed 9% Tiebreaker Adjusters

Initial Suggestions Received:

- Adjust, by addition (or subtraction), an applicant's actual credit request by amounts that reflect its lower (or higher) cost to be developed compared to the state average: square footage, location related costs, and wage rates
- Adjust, by subtraction, an applicant's actual credit request by the amount of foregone conventional debt resulting from its commitment to provide supportive services

Delayed 9% Tiebreaker Adjusters

<u>Pros and Cons:</u>

- Will allow all project types and project locations to compete on a level playing field
- Will allow prevailing wage projects and permanent supportive housing projects to compete on a level playing field
- Will require significant research and testing to create adjusters that effectively neutralize cost differences

Reduce Requirements for 4% Projects w/ CA Credits

Problem:

4% projects that are not eligible for the federal basis boost must commit to the same requirements as 9% projects to receive state tax credits, which reduces production

- Paying for energy efficiency measures increases the cost to produce the housing
- Using a 50% AMI average income limit and paying for social services, which other 4% projects are not required to do reduces the amount of conventional financing that can be used to finance additional units

Reduce Requirements for 4% Projects w/ CA Credits

Background:

- Historically, state credits have been used to promote affordable housing being developed in all areas of the state, not just QCTs and DDAs that get the federal boost
- The Governor’s budget proposal includes a sizable expansion of the state tax credit to be used for production, provided the industry achieves cost containment goals

Reduce Requirements for 4% Projects w/ CA Credits

Initial Suggestions Received:

- Remove the following requirements from 4% projects requesting state credits:
  - Energy efficiency measures
  - Lowest income targeting
  - Social service provision

Reduce Requirements for 4% Projects w/ CA Credits

Pros and Cons:

- Will lower the cost to produce the housing and achieve cost containment goals
- Will increase the amount of supportable conventional debt, which will lower the state's investment per unit
- Will raise the average level of affordability from 50% AMI to 60% AMI for such projects
- Will reduce the amount of social services available to residents and reduce energy sustainability slightly

Cost Containment Measures

Problem:
The cost to develop housing in California is rapidly increasing, which thwarts production

- Site amenity requirements in the 9% program restrict the supply of suitable sites, which raises land costs
- Water efficiency measures alone are insufficient to score maximum points
- Making 50% of senior units ADA accessible is costly

Cost Containment Measures

Background:

- Site amenity points are awarded when family projects are proximate to schools, but only one school is counted
- Water efficiency must be paired with energy efficiency measures to score maximum points
- Seniors that lack mobility constraints get less utility out of their unit when it's configured to be ADA accessible
- The California Building Codes require 5% of units be ADA accessible

Cost Containment Measures

Initial Suggestions Received:

- CDLAC & CTCAC: Count each proximate school that serves different ages for site amenity points
- Award 5-points for water efficiency measures (currently 3)
- Require senior projects to outfit 10% of units with ADA mobility features (currently 50%)
- Require rehab projects to retrofit 5% of units with ADA mobility features (currently 10%)

Cost Containment Measures

Pros and Cons:

- Will lower the cost to produce the housing, increasing production and achieving cost containment goals
- Will justly count the benefits of all proximate schools, thereby increasing the supply of land for housing projects
- Will promote water sustainability, an important goal for CA
- May frustrate energy sustainability and ADA accessibility advocates

Remove Eligible Basis Exclusions

Problem:

The 9% program excludes a project's eligible basis related to developer fee, parking, and offsite costs, thereby requiring it to obtain other state resources to achieve feasibility

Remove Eligible Basis Exclusions

Background:

- The developer fee limitation on eligible basis is a legacy provision included in a compromise in the 2000s to increase the developer fee limit beyond $1.4m
- The parking related limitation was implemented to give developers leverage over local agencies, which is ineffective
- The offsite related limitation was implemented to stop local agencies from skewing the tiebreaker
- Each of these limitations take time and money to certify, account for, and verify

Remove Eligible Basis Exclusions

Initial Suggestions Received:

- Allow all developer fee to be included in eligible basis like the 4% program
- Allow all parking costs to be included in eligible basis as developers have no control over local jurisdiction’s parking standards
- Include reasonable exceptions to the tiebreaker penalty for off-site improvements, so the program only polices bad behavior

Remove Eligible Basis Exclusions

Pros and Cons:

- Will lower the cost to submit applications, perform cost certifications, and place a project in services
- Will lower the time required by TCAC staff to process initial and placed-in-service applications

Include an Inflation Factor in Developer Fee Limits

<u>Problem:</u>
Every year the development community and program administrators argue about the limits on developer fees, resulting in increased limits every 5 or 6 years

- The cost to develop, the cost to do business, the cost to retain talent, the cash required, the risk assumed, and transaction complexity all rise continually from year to year, yet there is no commensurate increase in compensation

Include an Inflation Factor in Developer Fee Limits

Background:

- The last increases in developer fee limits were in 2016 when new construction 9% projects and 4% projects with more than 100 units received an increase
- The increases prior to 2016 were during (or around) 2008
- Similar to state agencies, the development community is suffering from a lack of analysts and project managers, as the industry cannot afford to pay staff what market rate developers pay

Include an Inflation Factor in Developer Fee Limits

Initial Suggestions Received:

- Include an annual inflation factor in the figures that govern the 9% and 4% program developer fee limits to be paid from development sources

Include an Inflation Factor in Developer Fee Limits

Pros and Cons:

- Will cause developer compensation to remain relevant for longer periods of time, thereby incentivizing talented firms to help California tackle its housing crisis
- Will reduce contention between future program administrators and the development community
- Will improve the talent pool of professionals focused on developing housing

Discontinue Re-testing Maximum Debt Service Coverage

Problem:

Projects face costly delays in repaying construction loans, delivering tax credits to investors, and closing out a project when re-testing the maximum debt service coverage ratio requires a project to be refinanced, years after closing its financing

- The additional construction interest, lost value to tax credit investors, and wasted effort by developers and TCAC staff that result from re-testing figures that change over time increases the cost to develop housing

Discontinue Re-testing Maximum Debt Service Coverage

Background:

- TCAC imposes a maximum debt service coverage ratio at the time of application to ensure projects actually need the amount of credits they are requesting
- Projects typically submit their placed-in-service applications 27 months after submitting their initial application and 20 months after locking in their permanent financing rates and terms
- Increases in rent limits based on unpredictable increases in AMI cause some projects to exceed the maximum DSCR

Discontinue Re-testing Maximum Debt Service Coverage

<u>Initial Suggestions Received:</u>

- Discontinue re-testing maximum debt service coverage ratios at placed-in-service

Discontinue Re-testing Maximum Debt Service Coverage

Pros and Cons:

- Will expedite the cumbersome process of approving placed-in-service applications
- Will add consistency for lenders and investors who commit capital to projects years before the final information is known
- Will reduce the cost of developing housing

Collect Data on Social Empowerment Goals

Problem:

There is a no data available to track improvements in empowerment goals (tenants and the development/contractor workforce) affected by program incentives

Collect Data on Social Empowerment Goals

<u>Background:</u>

- While some demographic data is collected in the application such as high/low opportunity areas, there is currently no place to communicate wealth building programs, opportunity programs, and or empowerment efforts

Collect Data on Social Empowerment Goals

<u>Initial Suggestions Received:</u>

- Expand the Construction and Design Description to include information about empowerment goals

Collect Data on Social Empowerment Goals

Pros and Cons:

- Will provide a means of collecting data that can be used to measure the impact of program incentives
- Will require additional information from all applicants

Other Proposals at a Glance

Initial Suggestions Received:

a. Add a Service Amenity point category option for classes/programs that help residents build wealth

b. Eliminate the requirement for lenders to commission capital needs assessments

c. Convert the four (4) project per round award limit to an eight (8) project annual limit, while disregarding nonprofit MGPs receiving less than 10% of developer fee

Other Proposals at a Glance

Initial Suggestions Received:

e. Set reasonable minimum thresholds of work needing to be performed on 9% rehab projects

f. Expand the authority to exchange 9% credit reservations to waiting list projects and large infill projects

g. Allow the project architect to certify to the project meeting CDLAC sustainability measures

h. Streamline the underwriting of commercial income

Goals

- Increase housing production
- Contain development costs
- Spur new technology
- Increase opportunity for women and people of color
- Empower individuals in distressed communities
- Build wealth for all Californians

CTCAC Regulation Change Process

6/28 - 7/23: Compile comments from City Tours and draft proposed regulation changes

7/23 - 9/6: Hold four (4) public hearings

9/6 - 9/27: Respond to public comment and revise proposed regulation changes

10/16: Committee considers adoption of proposed regulation changes

CDLAC Regulation Change Process

7/23:	Start Office of Administrative Law process
10/12:	Department of Finance review period
11/1:	OAL review completed
11/7:	Notice of a registered publication completed
12/22:	45 Day comment period ends
1/6:	15 Day comment period if applicable
3/7:	61 Day process if major changes
1/31 - 5/6:	Committee considers approval
Next day:	OAL provides final document

Regulation Design and Implementation for $500m

- Requires both CTCAC and CDLAC regulation changes
- Requires a competitive CDLAC scoring system
- To be expedited as much as possible
- To be separate from general program improvements
- Earliest implementation 2nd quarter 2020

Major Regulation Efforts

2019						2019	2020				2020
Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May
CTCAC Regulation Improvements											
CDLAC Regulation Improvements											
	$500m State Credit Program Implementation (CTCAC & CDLAC)										

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