

**CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE**  
**Minutes of the October 15, 2014 Meeting**

1. Roll Call.

Bettina Redway for State Treasurer Bill Lockyer chaired the meeting of the Tax Credit Allocation Committee (TCAC). Ms. Redway called the meeting to order at 11:15 a.m. Also present: Alan Gordon for State Controller John Chiang; Eraina Ortega for the Department of Finance Director Michael Cohen; California Housing Finance Agency (CalHFA) Executive Director Tia Boatman-Patterson; and Laura Whittall-Scherfee for Department of Housing and Community Development (HCD) Director Claudia Cappio.

City Representative Lucas Frerichs was absent.

2. Approval of the minutes of the September 24, 2014 Committee meeting.

MOTION: Mr. Gordon moved to adopt the minutes of the September 24, 2014 meeting. Ms. Ortega seconded and the motion passed unanimously.

3. Executive Director's Report.

Executive Director, William Pavão reported that staff concluded four public hearings in Sacramento, Oakland, Los Angeles, and San Diego. The hearings were related to the proposed regulation changes for next year. Mr. Pavão noted that the changes were fairly modest. Most of them were clarifying in nature. Mr. Pavão announced that the public comment period would end at 5:00 p.m. on Friday, October 24<sup>th</sup>. He stated that staff would consider comments received and produce and final statement of reasons in response to the comments. He stated that staff would bring the final proposed regulation package to the Committee for adoption at the December meeting.

Mr. Pavão reported that the December TCAC meeting was originally scheduled for December 10<sup>th</sup> and then moved to December 17<sup>th</sup>. He explained that he recently learned two Committee members would not be available for December 17<sup>th</sup> meeting.

Ms. Redway stated that she would be on vacation on December 17<sup>th</sup>. She had planned her vacation around the original December 10<sup>th</sup> meeting date.

Mr. Pavão asked Ms. Ortega if she had a schedule conflict as well.

Ms. Ortega stated that she would be attending a State Lands Commission event on December 17<sup>th</sup>. She noted that Mr. Gordon may be attending the event as well.

Mr. Gordon confirmed that he had the same scheduled conflict as Ms. Ortega.

Mr. Pavão explained that the original meeting date was postponed in order to give staff time to consider comments regarding the regulations and post their response within 30 days of the December meeting. He stated that he felt staff could accelerate their reviews and publish their final recommendations 30 days in advance of the December 10<sup>th</sup> date. He asked the Committee member to confirm they would be available to meet on December 10<sup>th</sup>.

Mr. Gordon, Ms. Ortega, and Ms. Redway confirmed that they would be able to attend the meeting on December 10<sup>th</sup>.

Mr. Pavão stated that the meeting would likely be rescheduled to December 10th.

Mr. Pavão reported that he put together a set of PowerPoint slides, which summarized key finding from the recently published cost study. He announced that the full study was linked to each State agency's website.

Ms. Redway asked Mr. Pavão is the study by Scott Littlehale was readily available to people.

Mr. Pavão stated that he did not know how that study was being publicized.

Ms. Redway stated that Mr. Littlehale reviewed the same public data TCAC reviewed.

Ms. Whittall-Scherfee reported that Mr. Littlehale brought his findings to the Non-Profit Housing (NPH) conference.

Mr. Pavão offered to link the study by Mr. Littlehale to the State agency websites.

Ms. Whittall-Scherfee stated that Mr. Littlehale represented the carpenters' union.

Mr. Pavão explained that Mr. Littlehale's key finding was that anything that reduced scale would add to per unit cost.

Ms. Redway stated that Mr. Littlehale's research provided a different view of the housing cost study. She suggested staff send a copy his study to the Committee members assuming it was available.

Mr. Pavão confirmed that the study was available and staff would send copies to the Committee members.

Mr. Pavão recommended the Committee not take up Agenda Item 5 that day. He stated that he would explain why the item was withdrawn later in the meeting.

4. Discussion and consideration of the 2014 Applications for Reservation of Federal Low Income Housing Tax Credits (LIHTCs) for Tax-Exempt Bond Financed Projects.

Mr. Pavão reported that there were 10 applications for 4% low-income housing tax credits. The projects were reviewed for compliance with state and federal statutory requirements. He recommended them for Committee approval. Mr. Pavão noted that 9 of the 10 projects were rehabilitation projects. He stated that 7 of the rehabilitation projects were re-syndication applicants. He explained that re-syndication projects were old tax credit projects that applied for another award of tax credits for purpose of capital improvements such as energy efficiency upgrades.

MOTION: Mr. Gordon moved to adopt staff recommendations. Ms. Ortega seconded and the motion unanimously.

5. Discussion and consideration of a Resolution, establishing a Waiting List of pending applications for Federal Nine Percent (9%) and State Low Income Housing Tax Credits (LIHTCs), provided that credit remain available and such applications are complete, eligible and financially feasible.

Mr. Pavão explained that the regulations gave the Committee authority to establish a waiting list each year at the end of the second funding round. He reported that TCAC has a balance of approximately \$5.6 million in federal credits. Mr. Pavão stated that staff intended to publish a waiting list and had already posted a preliminary list for public review on the TCAC website.

Mr. Pavão stated that the original preliminary list included 5 projects; however the staff had since changed the composition of the list. He explained that staff reviewed 2 more applications and reduced the tie-breaker score on one of them. The other application was disqualified. Mr. Pavão stated that each application went through the appeal process and late last weeks the appeals came to him for review. He reported that he honored both appeals, which resulted in the applications being added to the waiting list. Mr. Pavão noted that two applications on the original preliminary list would be taken off the list.

Mr. Pavão stated that staff would likely recommend a sixth project for the waiting list in part because the First Round award made to TCAC's very first Native American tribal community was being returned. He explained that the applicant was unable to proceed at that time and formally returned the credits even though staff communicated their willingness to help the project as much as possible.

Mr. Gordon asked Mr. Pavão where the project was located.

Mr. Pavão stated that the project was located in Bishop, which was in Inyo County. He reported that TCAC awarded credits to another tribe in the second funding round, which had maintained its credit reservation. Mr. Pavão stated that the Bishop project was a new construction projects which included 30 new units. He stated that the applicant suggested reducing the size of project and proceeding with a smaller phase; but ultimately they were unable to move the project forward at that time.

Mr. Pavão explained that the state and federal credits returned by the Bishop project had enlarged the amount of credits available through the waiting list; therefore staff would likely recommend a sixth project to the list. He reminded the Committee that the regulations specify how waiting list projects should be funded. He explained that staff must review each region that had credits remaining and fund the next pending applicant from that region. Mr. Pavão stated that if staff followed the protocol and still had credits remaining, as they would for 2014, they would refer to the state-wide ranked list of remaining project and review with the highest scoring, highest tie-breaker project first and work their way down the list. He stated that staff would likely recommend 4 regional projects and 2 projects from the state-wide list, which would exhaust the remaining federal credits.

Mr. Pavão pointed out that TCAC had no state credits available. In fact, TCAC over allocated state credits by about \$10.4 million. Mr. Pavão stated that TCAC had to reach into next year's allocation in order to make whole the allocations awarded to Second Round applicants. He noted that the language in regulations caught staff by surprise because the waiting list language handled the situation differently than staff did. Mr. Pavão explained that the waiting list language specified that if TCAC had a waiting list project requesting both federal and state credits, TCAC may offer the federal credits and give the applicant time to find financing to replace the missing equity resulting from TCAC's inability to give the project state credits.

Mr. Pavão stated there would be a project in Berkeley on the soon-to-be released waiting list, which requested federal and state credits. He reported that staff already advised the applicant of TCAC's intention to recommend the project be placed on the waiting list; however TCAC would only be able to offer the project federal credits. Mr. Pavão stated that the applicant signaled to staff that they were unlikely to find free money to replace missing equity in just 30 days. He stated that the applicant needed to find approximately \$1.6 million in replacement funding.

Mr. Gordon asked Mr. Pavão how the amount of state credits available to TCAC was determined each year.

Mr. Pavão explained that there were a couple of factors involved. First, TCAC usually had some credits remaining from the prior year. Also, state statute specified that \$70 million in annual state credits would be available to TCAC adjusted by a CPI multiplier. He concluded that the total amount of annual state credits available after the adjustment was approximately \$92 million.

Ms. Redway stated that the positive aspect of the situation was that state credits were being fully utilized. She noted that there was traditionally a surplus of state credits each year. Ms. Redway suggested that next year the Committee may want re-visit the policy regarding over allocation of state credits.

Mr. Pavão stated that one concern he expressed at the last meeting was that if the demand for state credits was high next year and TCAC reduced the amount

available by \$10.4 million, not only would TCAC not have prior year state credits to enlarge the amount available, the program would also have a deficit going in. He stated that the credits returned by the Bishop project totaled approximately \$3.6 million. Mr. Pavão commented that the returned credits was good in that TCAC only had to use \$6.8 million from next year's allocation; however the Berkeley project would likely inquiry as to what happened to the returned state credits. Mr. Pavão explained that the returned credits only reduced next year's deficit and TCAC still had no state credits to offer the Berkley project.

Mr. Pavão requested that staff take another month to settle the situation. He stated that staff would bring a waiting list, likely containing six projects, to the Committee at the meeting scheduled for November 12<sup>th</sup>.

#### 6. Public Comments.

Brad Weinberg stated that he was a partner at Novogradac & Company. He explained that he was the head of the firm's valuation group and a licensed appraiser who held the MAAI designation from the Appraisal Institute.

Mr. Weinberg stated that he came to the meeting to discuss the appraisal of tribal lands. He commented that he understood the Committee knew about the difficulties of appraising on tribal lands as it had already exempted tribal applicants from requiring the land appraisal for new construction. He stated that this made sense given that tribal lands cannot be sold. He stated that he believed there had been an oversight by the Committee as the regulations still required an appraisal on tribal land to use the income and sales comparison approaches to determine the proven value in acquisition/rehabilitation applications. Mr. Weinberg stated that it was his firm belief that the requirement should be amended to allow the cost approach to be used for determining improvements on tribal properties. Tribal communities were most often located in rural areas. They were generally no rental, expense or sales comparables or capitalization rate data for these areas. Mr. Weinberg stated that often there were no active real estate markets for 100 miles or more. As a result the reliability of the sales comparison in the income approach is significantly impaired. He stated that a second element further weakened the reliability of these approaches. The Committee did not require the valuation of the underlying land; recognizing the problem with applying market standards to land that cannot be sold. As a result any appraisal of the property for acquisition/rehabilitation application would be of the improvements only. Further, virtually all property sales included both the improvements as well as the underlying land.

Mr. Weinberg stated that in order to use the sales comparison approach an appraiser would not only have to identify sales well outside of the immediate area and in non-comparable markets, but the appraiser would also have to allocate the sales between the land and improvements to arrive at a sale price of the adjusted improvements to use in the sale comparison approach. Mr. Weinberg explained that this allocation process further reduced the reliability of the sales comparison approach for tribal lands. For the income approach, the problem was compounded because there were no market rents for improvements only. As a

result, some form of allocation would also need to be done on market rents to portion a level of comparable rents that were only going to support the value of the improvements.

Mr. Weinberg explained that there was also the issue of the appropriate capitalization rate for the valuation of improvements only. He reiterated that capitalization rates included a return to both the land and to improvements. And appraiser would somehow have to allocate the market to arrive at a capitalization rate between land and improvements before determining an appropriate capitalization rate. Mr. Weinberg stated that trying to value the properties using either approach in this situation would not result in a credible valuation and therefore would be in violation of the Uniform Standards of Professional Appraisal Practice (USPAP). USPAP standards 1 and 2 required the appraiser to “correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal” and “In reporting the results of a real property appraisal, an appraiser must communicate each analysis, opinion and conclusion in a manner that is not misleading.”

Mr. Weinberg stated that he felt only the cost approach was appropriate in these situations as it provided the only approach that resulted in a credible value as required under USPAP. He commented that understood the issue was relatively new to the Committee. He noted that the issue of valuation of improvements in tribal lands had been tackled by others. Most recently, Arizona included the following language in its draft 2015 Qualified Allocation Plan (QAP). “Projects on tribal land may submit a cost based appraisal utilizing an appraisal guide book published by the Department of Housing & Urban Development Valuation analysis for single family 1-4 unit dwellings and directive 4150.02.

Mr. Weinberg stated that directive 4150.02 dealt specifically with appraisals on native land and detailed the difficulty of these appraisals and why the cost approach is often best. The guidance specifically stated on page 5 that “the cost approach is often the primary indication of value based on the unique nature of the reservation setting”. Mr. Weinberg stated that Arizona was the most recent organization to recognize the cost approach as often the only applicable approach to value on tribal lands. The United States Department of Agriculture (USDA) published guidance in the publication, *Lending on Native American Lands*, in June 2006. Mr. Weinberg explained that publication described the difficulty of valuation of tribal properties and suggested that the cost approach was the most applicable approach. On page 28, the publication noted that in 1996 the agency issued AN 3267, “authorizes the use of a cost approach appraisal in designated areas, while removing with certain exceptions the major constraint the cost appraisals: consideration of external depreciation.” Mr. Weinberg explained the change in applying the cost approach had been similarly applied to the Section 502 guarantee program.

Mr. Weinberg stated that in 1999 there was a study conducted by the Housing Assistance Council on the cost based appraisals on Native American trusts. The council likened appraisals on land trusts to those in rural areas, which shared the same difficulty in finding comparables. The council advocated for the cost based

approach and the main findings included that the cost based approach was a necessity on trust lands. Due to a lack of sales and housing production on trust lands, cost based appraisals were the last resort method yet absolutely necessary to facilitate affordable housing in often remote and depressed areas. Mr. Weinberg reported that the council also found that cost based appraisals were almost exclusively being used on trust land. A survey of rural housing producers and appraisers from states with high numbers remote rural counties revealed that cost based appraisals were generally the only approach being used on trust lands.

Mr. Weinberg stated that providing credible real estate appraisals on tribal lands was a long standing issue, but it was clear that the preponderance of available guidance and public analysis supported the use of the cost approach in the absence of comparable information. He stated that he was not aware of another state that required either the income or the sales comparison approach be used in appraising the value of properties on tribal lands. California was alone in that regard. Mr. Weinberg encouraged the Committee to consider amending the appraisal requirements to allow for the use of the cost approach for tribal lands.

Mr. Gordon asked Mr. Weinberg to explain the difference between the accounting approaches.

Mr. Weinberg explained that there were 3 approaches to establishing value: income approach, sales comparison approach, and cost approach. The income approach examined what kind of revenue could be generated by the property. The approach removed expenses for operating the property to arrive at an income known as net operating income; that is the income available for debt service and other items. He explained that there was a method of converting the net operating income into an indication of value. He stated that the capitalization rate was used to convert the income into a value by reviewing other sales in the market place.

Mr. Weinberg explained that the sales comparison approach considered other properties that had sold.

Mr. Gordon stated that he understood the sales comparison approach and would like Mr. Weinberg to explain the cost approach.

Mr. Weinberg stated that the cost approach was a cost based method that considered the replacement cost of the existing improvements. He stated that there was a deduction for depreciation associated with physical or functional depreciation or external obsolescence.

Mr. Gordon asked Mr. Weinberg to explain to him how the appraisal process would work if a tribal government were trying to build housing on its property. He asked how the current protocol would be different than the approach Mr. Weinberg was advocating.

Mr. Pavão pointed out that Mr. Weinberg only referred to rehabilitation projects in his comments.

Mr. Weinberg confirmed that he had referred only to existing properties. He stated the regulations currently required the income and sales comparison approaches to be used. They did not allow the cost approach to be used.

Mr. Gordon asked Mr. Weinberg to explain why the cost approach was better than other appraisal approaches.

Mr. Weinberg stated that the cost approach was simply an estimation of replacement cost. He stated that there were published sources of information about the costs involved in building on tribal land. He explained that an appraiser would come up with an indication of how much it would cost to build the property new and then deduct depreciate for the fact that the property wore out over time. Mr. Weinberg stated that the approach results in an indication of what the depreciated cost the improvements were. He stated that the cost approach was in fact an improvement only analysis. It used cost data and estimated depreciation to arrive at the indication of value for the property in its current state.

Mr. Gordon asked Mr. Weinberg to explain the advantages of using the existing system of appraisals.

Mr. Weinberg stated that in most cases he advocated for the sales and income approaches first because felt they were generally more reliable when the property was in an actual existing market. He explained that USPAP guidance instructed appraisers to review the available data to determine which appraisal approach made the most sense. He concluded that based on the available data, the only approach that made sense for tribal lands was the cost approach, but appraisers were precluded from using that method.

Mr. Gordon asked Mr. Weinberg if he could provide an argument for someone who thought the cost approach was not the best option.

Mr. Weinberg stated that he did not feel he could provide such an argument in this situation.

Mr. Pavão stated that he understood Mr. Gordon's question. He explained if someone wanted to determine an appropriate sale price for their home, that person would not use an approach that calculated the cost of rebuilding their home; but rather the person would review the prices of other homes for sale in their neighborhood.

Mr. Gordon asked Mr. Pavão why the appraisal system should be applied to tribal lands which could not be legally sold. He asked if Mr. Pavão's interpretation of the existing regulations was the same as Mr. Weinberg's. He stated that Mr. Weinberg would be required to value a rehabilitation property on tribal land in the same manner it was done in everywhere else.

Mr. Pavão stated that appraisals have been done in the same manner in remote rural areas of California. He stated that rural properties have confronted several of the issues Mr. Weinberg mentioned such as sparsely populated communities,

few sales in the area, and difficulty finding truly comparable properties. He stated that it was important that we use that value of that improvement for basis purposes to determine how much credit to award. Mr. Pavão stated that lenders on the property would be trying to establish the value perhaps for other purposes such collateral for the loan, whereas TCAC was trying to establish the value purposes of the federal tax credit program that needs a good estimate of value to make sure TCAC delivered the right amount of credits to the project. Mr. Pavão stated he was interested in learning more about this issue and would confer with more appraisers. He noted that TCAC was receiving conflicting reports on the issue.

Mr. Pavão described a scenario in which a tribal community was in a larger rural area and there was a single family home on the tribal land. He stated that staff received conflicting reports on whether an appraiser could estimate a market price for which the residence could be sold. He stated that it was still an open question as to whether an appraiser could estimate the value of the home on tribal land if there were no comparable on the tribal land but other single family homes selling within a reasonable radius of homes sold recently.

Mr. Weinberg stated that that the complication aside from the rural nature was the issue of the land itself. When the houses sold even in the area Mr. Pavão discussed they sold with both land and improvements. Then the appraiser must figure out an apportionment for that. He stated that if one continued down that “rabbit hole” of reliability to the point where there were serious issues as to whether or not an appraiser could provide a credible value.

Ms. Redway asked Mr. Weinberg to confirm that he would have the same opinion whether or not the tribal land was in an urban or rural area.

Mr. Weinberg stated that he would not be of the same opinion with regard to urban area tribal lands. He reiterated that the regulations required the sales and income approach to be used and precluded the cost approach in appraisals. He stated that he felt the appraiser should be allowed to determine which method was best for a particular market.

Mr. Gordon asked attorney Patrick Sabelhaus to comment on the issue. Mr. Gordon stated that Native American properties were seen more rarely than rural properties so he wanted Mr. Sabelhaus’ opinion.

Mr. Sabelhaus stated that the poorest reservations, which were some of the largest, were totally isolated. He stated that he understood what Mr. Pavão had said. If Roner Park where the new Indian Casino was built, it was a different situation from the 58 rancherias in northern California from the valley through Crescent City. Mr. Sabelhaus stated that some of these tiny places did not even have road ways. He stated that they were accessible only by dirt road. He stated that the Paiute tribe that returned the credits was not quite as isolated as some of the small rancherias. He stated that the tribe had a casino and some financial wherewithal; however he felt the tribe would still have difficulty due to the ground lease that was insisted upon by the BIA and the statutes that controlled the

reservations. Mr. Sabelhaus stated that every situation that Mr. Weinberg advocated was probably different and therefore appraisers should be able to choose the appropriate valuation method. And they should be able to defend why they were using the cost method if they had to use it because there was no other way to get comparables or use a cap rate to get the appropriate data. Mr. Sabelhaus stated that he was sympathetic to making the program as flexible as Mr. Pavão has tried to do with his staff. He stated the program has existed for 28 years and it only recently established a Native American set aside because Treasurer Lockyer was sympathetic to those who approached him representing tribes from all over. Mr. Sabelhaus stated that TCAC would have to be extraordinarily flexible if it was going to be able to develop any properties on the reservations. He stated that if the program set aside approximately \$500,000 per funding round then it was definitely worth finding a way to get the money expended on behalf of some of the tribes.

Ms. Redway reiterated Mr. Pavão comment that TCAC used the appraisals for the purposes of basis rather than collateral. She stated that the appraisal served a different function in her opinion than it did in the normal way TCAC used appraisals. She asked if anyone had an opinion on impact what TCAC was doing.

Mr. Weinberg stated appraisers wanted the maximum flexibility in these situations to allow for a reliable appraisal. He stated that TCAC had the ability to create the flexibility. He stated that from a valuation stand point he did not think there was anything particularly different.

Mr. Sabelhaus stated that the appraisal did not have a lot to do with what a bank would want because the bank was only going to receive a ground lease anyway. On Indian reservations it was only 50 to 55 years. The regulations were flexible enough to accommodate that due to the BIA rules. Mr. Sabelhaus stated that the bank was pretty much at risk. Bank of American, which was providing construction financing for the Paiute tribe project, did not care about taking a secured interest in the land because it was a ground lease for 50 years and BIA had an enormous amount of control of the trust lands. He explained that Bank of American just looking for ways to ensure their loan would be expended properly to help finished project after which the construction loan would be repaid out of the tax credits.

Mr. Weinberg stated that there were 2 reasons for appraisals for lending purposes. One reason was the construction loan and the other was for permanent financing. And when a project was in a permanent financing stage it had an existing rehabilitated property so there was no interest in the valuation that was used to get the cost for the credits. Mr. Weinberg stated that during construction lenders were very interested in making sure funding was expended as intended but outside of that reason they had no interest because they could not legally hold an interest in land.

Mr. Sabelhaus stated that Arizona recently changed its regulations based on an appeal brought by one of the tribes. He stated that Arizona had to have flexibility

in order do some tax credit projects on tribal lands in Arizona, which had vastly more land associated with the tribes in comparison to California.

Mr. Gordon thanked Mr. Weinberg and Mr. Sabelhaus for their comments.

Mr. Sabelhaus asked Mr. Pavão if there would be a waiting list for purposes of the rural set aside in case any projects dropped out.

Mr. Pavão stated that staff did not envision creating a rural set aside waiting list.

Mr. Sabelhaus stated that in past years there was a set aside list for the rural area so that if any dropped out of the program, the next project on the list could be funded to make the statutory 20% was in fact expended.

Mr. Pavão stated that staff did not envision creating a rural waiting list. He explained that TCAC had not had a waiting in the last couple of years. He state that staff ordinarily generated waiting lists when there was a surplus of credits.

Mr. Sabelhaus asked Mr. Pavão if the return of credits by the Bishop tribe, which was part of the rural set aside require that TCAC fund another project from the rural set aside.

Mr. Pavão stated that he would research Mr. Sabelhaus' question. He commented that he did not believe another rural project had to be funded because TCAC discharged its statutory obligation by making reservations for more than 20% of its credits for rural projects. He stated that he would check the regulations regarding returned credits and review how much credit was returned and how much TCAC over allocated. Mr. Pavão explained that TCAC used the 1 dollar rule so the program almost always awarded more credits than were available. He stated that he would check to see how much was awarded to rural projects in 2014.

## 7. Adjournment

The meeting adjourned at 11:57 a.m.