CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE
Minutes of the March 18, 2015 Meeting

1. Roll Call.

   Alan Gordon for State Treasurer John Chiang chaired the meeting of the Tax Credit Allocation Committee (TCAC). Mr. Gordon called the meeting to order at 2:00 p.m. Also present: Lynn Paquin for State Controller Betty Yee; Eraina Ortega for the Department of Finance Director Michael Cohen; Donald Cavier for California Housing Finance Agency (CalHFA) Executive Director Tia Boatman-Patterson; Department of Housing and Community Development (HCD) Director Claudia Cappio; and City Representative Lucas Frerichs.

2. Approval of the minutes of the January 21, 2015 Committee meeting.

   MOTION: Ms. Paquin moved to adopt the minutes of the January 21, 2015 meeting. Ms. Ortega seconded and the motion passed by a roll call vote.

3. Executive Director's Report.

   Executive Director, Mark Stivers announced that March 3rd was the deadline for project sponsors to submit competitive applications for the 2015 First Round. He reported that TCAC received 81 applications for 9% tax credits and 9 applications for 4% plus state credits. He noted that each category was oversubscribed by a ratio of 2:1. Mr. Stivers estimated TCAC would award 40 projects; however that number was subject to change as staff conducted the scoring reviews. He announced that the final recommendations would be made at the TCAC meeting scheduled for June 10th.

   Mr. Stivers reported that the listening sessions were almost complete. He stated that a session was scheduled for next week and staff may also seek out 1 or 2 additional groups to meet with. He noted that that Jeree Glasser-Hedrick, Executive Director of the California Debt Limit Allocation Committee (CDLAC) spoke earlier that day about a number of issues discussed at the listening sessions.

   Mr. Stivers reported that the State Controller's Office (SCO) was specifically interested in the developer fee proposal, which mainly related to the 4% tax credit program. Although there was some interest in increasing developer fees in the 9% program, staff determined that doing so would result in fewer projects being funded. Mr. Stivers explained that increasing developer fees in the 4% program would result in greater basis and would allow developers to qualify for more credits. In addition, projects could close some of their funding gaps.

   Mr. Stivers reported that most states used 15% of basis as the cap on developer fees, whereas TCAC limited fees to 15% of basis or $2.5 million; whichever is less. He explained that a lot of projects, especially those with more than 60 or 80 units, had probably reached the $2.5 million cap. With respect to projects that receive public funds, he expressed concern that TCAC's funding partners would be impacted if the fee limit was increased. He stated that increasing the developer fee would generate additional equity but also increase project costs, which the public lenders could be asked to fill. Mr. Stivers explained this upfront cost increase is avoided if the additional developer fee is deferred contributed back to their project. Mr. Stivers stated that this was not an issue in situations where there were no public funds committed.

Mr. Gordon asked Mr. Stivers to explain why increasing the developer fee would result in increased costs for 4% projects but not 9% projects.

Mr. Stivers explained that increasing fees would result in increased costs for both types of projects. The developer fee counted toward the eligible basis from which the tax credits were computed. If the eligible basis was increased on 9% projects, the amount of credits for those projects would increase resulting in fewer projects being funded. Mr. Stivers explained that increasing credits awarded to 4% projects would not necessarily decrease the number of funded projects because 4% credits are unlimited.

Mr. Gordon asked Mr. Stivers to explain the connection between the increased fees and the public funding sources.

Mr. Stivers stated that if TCAC were to increase the current developer fee limit by $1 million, the cost for a given project would increase by $1 million. The additional basis would generate about $350,000 (35% of $1 million) in equity. The project in this scenario would have an increased funding gap because the project costs increased by $1 million and the equity increased by only $350,000.

Mr. Stivers explained that when public funds were committed to a project, the developer could pressure the local government or public entity to increase its loan amount enough to cover the additional funding gap. He stated that staff was seeking ways to help close funding gaps rather than increase them. He explained that developers could mitigate the gap issue in two ways.

Mr. Stivers explained that if the developer contributed the extra $1 million back to the project, the actual cost would not increase. Likewise, if the extra $1 million was deferred (i.e. paid back over time), the upfront cost of the project would not increase and funds would be paid out of cash flow at a later time. Mr. Stivers stated that a fee deferral, however, can impact local lenders in another way. Some require partial loan repayments from the residual receipts (i.e. the available cash flow) on a regular basis. If the cash flow goes to pay a deferred developer fee, these public lenders will see less residual receipt income over time+.

Mr. Stivers commented that TCAC staff was very interested in the proposal of generating additional equity. He assured the Committee that staff would be careful so as not to increase funding gaps or negatively affect the ability of public lenders to be repaid.

Mr. Gordon asked Mr. Stivers if both for-profit and non-profit developers supported the proposal. He asked if one group felt more strongly about it than the other.

Mr. Stivers stated that both groups supported the proposal. He explained that TCAC was seeking ways to make 4% projects feasible. And there were still untapped resources that could help fill project gaps. Mr. Stivers stated that equity made available through federal tax law was one resource TCAC could use. He noted that staff would try to be careful in their approach so they would not negatively affect lenders.

Mr. Gordon asked Ms. Cappio to give her thoughts on the proposed increase in the developer fee.

Ms. Cappio commented that the rational of the proposal was valid; however there was still the problem of increased funding gaps as Mr. Stivers pointed out. She stated that there were very few sources of money to fill the gaps. In the past there were more sources available including redevelopment (RDA) funds. Ms. Cappio stated that RDA funds were largely used to fill gaps. She stated that her agency was currently in discussion about the proposed change in the developer fee and also with the alignment of programs so that tax credits could be utilized to their greatest value.

Mr. Gordon invited Pat Sabelhaus to comment on the issue from a developer's perspective.

Mr. Sabelhaus stated that he agreed with Mr. Stivers and Ms. Cappio. He stated that there were projects that could be developed in this rather difficult market if TCAC revised the regulations to improve the financial position of the projects. He stated that the example Mr. Stivers provided was accurate except he would have added that when a project existed in a high cost area, a difficult to develop area, or a qualified census tract which provided a 30% boost and the developer fee shifted from $2.5 million to $3.5 million; the project would get a 30% boost on the $1 million for eligible basis purpose. As a result, such projects would end up with a greater increase in equity than the 35% from Mr. Stivers' example. The project would increase its cash from the syndicator to roughly $450,000 of the $1 million increase in developer fees.

Mr. Sabelhaus stated in a scenario where the developer fee increased by $2 million (for a larger project) the project owner would get about $900,000 of the $2 million. And they could use the funds to cover a financing gap. He noted that the impact of the proposal applied to large projects. He explained that it would not have much impact on projects with less than 80 to 100 units.

Mr. Sabelhaus stated that the California Council for Affordable Housing reviewed a number of projects and considered changes that could be made to the regulatory requirements and the developer fee. He commented that he did not think the policy regarding 60% rents being allowed versus 10% at 50% would likely impact projects. However, other proposed changes could help increase production by

3,000 or 4,000 units this year because there were projects in the pipeline that could not move forward.

Mr. Sabelhaus reported that there was a pending bill that could increase the amount of state credit available. He explained that tax-exempt bond projects were limited by statute to a 13% state credit whereas the 9% program was allowed a 30% state credit. He stated that the 30% state credit would be available to tax-exempt bond projects if the statute was amended as described in the proposal. He predicted there would be an increase in the total amount of state credit as a result of the amendment; however TCAC would likely receive a number of previously unworkable projects. Mr. Sabelhaus stated that he strongly supported all that Mr. Stivers said was under consideration by the Committee

Mr. Gordon reported that Janet Yellen, Chair of the Federal Reserve, signaled that interest rates would not be raised at that time, but any time after April the Federal Reserve expected rates to increase. He asked the board if interest rate activity had any effect on the calculations TCAC was working on. He stated that the gap between tax-exempt and taxable awards was quite narrow and as interest rates increase, the tax-exempt awards would become more valuable.

Mr. Stivers stated that increased interest rates would cause projects to become more expensive, but would also make the tax-exempt bond program look relatively better. He concluded that increased interest rates could result in more TCAC applicants, but also widen the project funding gaps.

Ms. Paquin asked Mr. Stivers if participants at the listening sessions had a preference for contributing the increased developer fee to equity versus deferring the payments.

Mr. Stivers stated that the opinions were split. He explained that developers would like to realize some of the benefits while many local governments were concerned with getting residual receipt payments at the back end. Mr. Stivers commented that he liked the equity contribution idea but he thought TCAC may be able to develop a hybrid system that would allow the program to implement a bit of both.

Mr. Stivers touched on a number of other issues regarding the 9% program. He stated that TCAC has a Native American set aside of $1 million that is scheduled to conclude at the end of the year. He stated that there was general support for continuing the program.

Mr. Stivers stated that site amenities were valuable to TCAC. Though most people approved of having site amenities in general, there was some broad interest in expanding the radiuses that TCAC used for amenities. He explained that when there was a tight radius around schools, hospitals, stores, and transit centers, fewer properties were eligible for the program, which drove up the cost to purchase the properties.

Mr. Stivers reported that staff had been communicating with their state partners about ideas related to projects that had gone through multiple state competitive rounds. Staff was considering whether TCAC should reserve tax credit awards to projects that received a competitive state award (from HCD for example) or make them go through the uncertain process of competing for credits.

Mr. Stivers stated that he would continue to bring updates to the Committee on the ideas presented. He predicted staff would bring formal suggestions to the Committee through the normal regulatory process in late summer or early fall.

Mr. Stivers stated that at the last meeting he reported on several projects that did not exceed the 130% high cost threshold when they applied for tax credits. He reported that the projects were now exceeding the threshold as construction bids were received and the developers closed on their actual costs. Mr. Stivers stated that staff did not find any willful misrepresentation of costs among the projects therefore the regulations would not penalize them in this situation. He noted that some board members expressed interest in having developers come before the Committee to explain why their projects exceeded the 130% threshold. He suggested developers could explain what factors were driving the costs and give staff a sense of what was going on in the market place.

Mr. Stivers reported that there were currently 3 bills he felt were relevant to the TCAC at that time. Two of the bills affected the program directly. He explained that AB 35, introduced by Assembly Member Chiu, would increase the amount of state low-income housing tax credits by $300 million per year. He stated that the legislation would help fill project funding gaps especially if the credit factor was to change as Mr. Sabelhaus described.

Mr. Stivers reported that another bill sponsored by the Treasurer, SB 377, would also affect the program. He explained that state tax credits generally sell for $0.65 on the dollar. When taxpayers reduce their state taxes, they end up owing more in federal taxes because state taxes are generally deductible from federal taxes. Mr. Stivers stated that staff was looking for a way to prevent state credits from being subject to federal taxation. In doing so staff could increase the price of state credits closer to $1.00. He noted that other states have found ways to accomplish this goal. Mr. Stivers concluded that SB 377 was created to give investors the ability to purchase state credits at their full value rather than a lesser value due to the federal taxation.

Mr. Stivers reported that another bill of note, AB 1335 was introduced by the Speaker of the Assembly. AB 1335, which staff referred to as the permanent source bill, was similar to SB 391 of last year. AB 1335 would provide for a $75.00 document recording fee on real estate related documents (except for sale documents) which would fund a housing trust fund. Mr. Stivers stated that it was not determined how the trust fund money would be spent. He suggested the funds could be used to support programs ranging from homelessness to homeownership. And a large portion of funds would likely go toward rental housing, which would allow TCAC to fill project funding gaps.

Mr. Stivers announced that staff withdrew an item from that day's Agenda. The item proposed an emergency regulation change related to the Department of Justice settlement funds. He explained that the change affected only one project. He stated that the issue was not about a substitution of private funds for public funds. Mr. Stivers explained that there was an increase in equity due to the credit price being higher than expected. Staff was able to resolve the matter through the existing regulations thus eliminating the need for the regulation change.

4. Discussion and consideration of the 2015 Applications for Reservation of Federal Four Percent (4%) Low Income Housing Tax Credits (LIHTCs) for Tax-Exempt Bond Financed Projects.

   Development Section Chief, Anthony Zeto, reported that staff recommended 13 projects for approval. The projects were reviewed for compliance with federal and state regulations. He brought the Committee's attention to a golden rod copy of the revised Staff Report for Madrone Apartments (CA-15-814). He explained that there was an error in the income targeting reported by the project sponsor. While the error affected other parts of the Staff Report, it had no effect on the recommended credit amount. Mr. Zeto reported that staff sent a copy of the revised Staff Report to the sponsor.

   MOTION: Ms. Ortega moved to adopt staff recommendations. Ms. Paquin seconded and the motion passed unanimously by a roll call vote.

5. Public Comments.

   No comments.

6. Adjournment

   The meeting adjourned at 2:20 p.m.