CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

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DATE: February 23, 2017

TO: Tax Credit Allocation Commmittee Members

FROM: Mark Stivers, Executive Director

SUBJECT: Final Proposed Emergency Regulation Changes

The prospect of federal tax reform legislation has resulted in a precipitous and drastic change in the tax credit market. Many projects awarded tax credits in 2016 now face funding shortfalls that jeopardize closing and completion. In an effort to assist these projects, Tax Credit Allocation Committee (TCAC) staff is proposing to allow 2016 9% tax credit awardees that have not yet closed their construction financing to convert their projects to a hybrid 9%/4% tax credit structure to bring in additional 4% tax credit equity on the excess basis. In addition, the market turmoil has required developers to seek additional financing sources and/or value engineer their projects, leading to timing delays in starting construction. Developers who pursue the hybrid 9% and 4% credit structure will see further delays as a result of reconfiguring their projects. While TCAC cannot alter the federal placed in service deadlines associated with 2016 9% credit reservations, the proposed regulation changes allow 2016 new construction projects with a second round reservation or that are pursuing the hybrid structure to return the 2016 reservation in exchange for a 2017 reservation, which adds a year to the placed in service deadline. Applicants exchanging federal credits may also exchange state credits to be eligible to "certify" the state credits.

These proposals require regulation changes. Given the unforeseen circumstances, the need to act quickly to keep these projects alive, and the desperate need for affordable housing in California, staff proposes these regulatory changes as emergency regulations.

Below is the Final Statement of Reasons with the final proposed regulation changes. These changes will be agendized for the March 15 meeting.

1. Section 10325.5

Proposed Change

10325.5(a) Projects that received a reservation of 9% tax credits in 2016 and that have not yet closed construction financing may request permission from the Executive Director to split the project into two with one

maintaining the 9% credit reservation and the other receiving 4% tax credits on any unutilized basis. Projects receiving such permission, in the aggregate, shall maintain the rent and income targeting, point score, and amount of public funds cited in the initial 9% staff report. In addition, projects receiving such permission, in the aggregate, shall be subject to the high cost test described in Section 10325(d) and shall not increase the developer fee in cost beyond the limit stated in the initial 9% staff report but may claim 4% tax credit basis for any portion of the developer fee, including the amount above the 9% limit in eligible basis. Notwithstanding the timing requirements of Section 10322, TCAC may use any documents submitted with the original 9% application to satisfy the application requirements of Section 10322. If permission is granted, the Executive Director shall revise the 9% tax credit reservation in accordance with the revised TCAC feasibility analysis, provided that the amount of reserved tax credits does not increase.

(b) A new construction project that received a reservation of 9% tax credits in the second round of 2016 or that is receiving permission pursuant to subdivision (a) may elect to return all of the 2016 Federal Credit, and State Credit if applicable, in exchange for a new reservation and allocation of 2017 Federal Credits, and State Credits if applicable.

(1) If pursing a hybrid structure pursuant to subdivision (a), the election shall occur at the time the revised 9% and new 4% applications are submitted. If the applicant elects to return the 2016 9% Federal Credit, and State Credits if applicable, upon acceptance of the 4% tax credit reservation, the reservation and carryover allocation of the 9% Federal Credits and the reservation of State Credits returned pursuant to this subdivision shall be deemed cancelled by mutual consent pursuant to a written agreement executed by the Committee and the applicant. The Committee concurrently shall issue a new reservation of 9% Federal Credits, and State Credits if applicable, to the project in an amount equal to or less than the amount of Federal and State Credits returned by the project to the Committee, in accordance with the revised 9% reservation.

(2) If the project is not pursuing a hybrid structure pursuant to subdivision (a), the election shall occur in the form of a written request submitted to CTCAC prior to any deadline the Executive Director may establish. The reservation and carryover allocation of the 9% Federal Credits and the reservation of State Credits returned pursuant to this subdivision shall be deemed cancelled by mutual consent pursuant to a written agreement executed by the Committee and the applicant. The Committee concurrently shall issue a new reservation of 9% Federal Credits, and State Credits if applicable, to the project in the amount of the Federal Credits and State Credits returned by the project to the Committee.

Reason: In the face of unforeseen disturbances in the tax credit markets, staff hopes to help 2016 9% tax credit projects that have not yet closed to fill financing gaps and complete construction. Staff is opposed to granting additional 9% credits outside of a new competitive round but is supportive of making 4% tax credits available to such projects where possible. The idea is to allow projects that have significant excess basis to split the original project into two components, with one component remaining a 9% project and other becoming a 4% project that utilizes the excess basis.

In order to allow for this hybrid structure, a few regulations changes are needed. First, the regulations need to allow for changes to projects that have already received an award. TCAC does not currently allow an applicant to reduce the number of units, alter the point score or tiebreaker, or reduce public funds to the project. A project converting to the hybrid structure necessarily will need to reduce the number of units in the 9% portion of the project, and changes to the point score, tiebreaker, and allocation of public funds may be necessary. As a result,

for only those 2016 awardees who seek permission to use the hybrid structure, staff proposes to allow the Executive Director to approve changes to the original 9% project on the condition that the aggregate of the 9% and 4% components maintain the rent and income targeting, point score, and amount of public funds cited in the initial 9% staff report. In addition, staff proposes to enforce the high cost provisions of Section 10325(d) at placed in service on the aggregate 9% and 4% project components. Staff does not support allowing the hybrid structure to circumvent controls on high-cost projects.

Second, the current regulations limit 2016 9% project developer fees to specific percentages of basis or $2 million in cost and $1.4 million in basis. Staff proposes to maintain this limit on developer fee to the 9% and 4% components in the aggregate. While there are likely additional costs associated with the hybrid strucuture, staff does not believe that applicants should receive a higher developer fee as a result of using the hybrid structure. Staff does propose, however, to allow the applicant to claim 4% tax credit basis for any portion of the developer fee, including the amount above the 9% limit in basis.

Third, staff will provide additional guidance on the application submission requirements for projects seeking permission to use the hybrid structure but seeks regulatory authority to use as much of the original 9% application materials as possible, even in cases where certain documents have become stale pursuant to the TCAC regulations. The proposed change, for example, would relieve the applicant of the need to update the appraisal, market study, or capital needs assessment due to timing requirements. Applicants should be advised, however, that they may still need to conduct such updates for CDLAC.

Fourth, regulatory changes are needed to address timing issues. Pursuant to federal law, projects that received 2016 tax credit reservations have a placed in service deadline of December 31, 2018. The recent market disturbances have delayed 2016 awardees already, and TCAC has extended closing deadlines for second round projects to the later of a) the date that is two months later than the readiness closing deadline stated in the project's reservation letter; or b) June 30, 2017. This places new construction projects, which generally have longer construction timelines, in jeopardy of missing the 2018 placed in service deadline. Staff has no authority to move the placed in service deadline. As an alternative, however, staff proposes to allow *new construction only* that received a 2016 second round award or that are seeking permission to convert to a hybrid structure to reset their credit year by exchanging their 2016 credits for 2017 credits. The current regulations allow this for high-rise projects only. As a result, the new construction projects that exchange their credits would have a new placed in service deadline of December 31, 2019.

Fifth, with respect to high-rise projects, the current regulations only reference an exchange of federal credits, and the initial proposed regulation changes mirrored this language for the 2016 credit exchanges as well. Normally, there is no need to reset state credits as they carry no placed in service deadline. Given the recent authorization for projects receiving 2017 state credits to "certificate" those credits, however, the revised proposed changes allow projects resetting federal credits to also reset 2016 state credits for 2017 state credits in order to facilitate certification. To the extent that certificated credits bring in higher equity pricing, this will also help close financing gaps.

2. Section 10337(a)(4)

Proposed Change

Section 10337(a)(4) All projects that receive a reservation of Tax Credits on or after January 1, 2017 and that involve a leasehold interest shall, in addition to the regulatory agreement, execute a lease rider which shall be recorded against the property.

Reason: Staff recently became aware that its regulatory agreements did not properly reflect situations in which the project owner does not own but rather has a leasehold interest in the underlying land. Staff recently began recording lease riders to ensure that the property owner is aware of and a party to the regulatory agreement on the project. Staff believes that it is helpful to codify this practice in the regulations. While not directly related to the issue of hybrid projects, the fact that hybrid projects will likely involve leasehold interests makes the correction both more relevant and timely. The proposed change requires all projects involving a leasehold interest that receive a reservation of tax credits on or after January 1, 2017 to execute a recorded lease rider in addition to the regulatory agreement. It is TCAC's intent in the meantime also to record lease riders on all projects that involve leasehold interests and that will execute regulatory agreements on or after January 1, 2017, even if the credits were reserved in a prior year. It is not TCAC's intent at this time to record lease riders for projects that already have an executed regulatory agreement.