CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

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DATE: February 3, 2017

TO: Tax Credit Stakeholders

FROM: Mark Stivers, Executive Director

SUBJECT: Proposed Emergency Regulation Changes with Initial Statement of Reasons

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 second round 9% tax credit awardees 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 order to accomplish this, regulation changes are required. 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.

Attached for public review and comment are the regulation changes proposed by TCAC staff along with a statement of reasons. Changes to the current regulations are indicated with red type. The target date for regulation change adoption is March 15, 2017, though it is possible a special meeting will be called at an earlier date. Interested persons wishing to express their views on the proposed regulation changes may submit written comments to TCAC by 5:00 pm on Friday, February 17, 2017. Comments should be emailed to mark.stivers@treasurer.ca.gov, preferably in a Word document or in an electronic rather than scanned pdf. format that allows for copying. While TCAC welcomes public comments, staff encourages commenters to be sparing and brief given the short timeframe for staff to turn around responses. Persons who have questions may contact me directly at in lieu of submitting formal comments.

1. Section 10325.5

Proposed Change

10325.5(a) Projects that received a reservation of 9% tax credits in the second round of 2016 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 receiving permission pursuant to subdivision (a) may elect to return all of the 2016 Federal Credit in exchange for a new reservation and allocation of 2017 Federal Credits. 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, upon acceptance of the 4% tax credit reservation, the reservation and carryover allocation of the 9% Federal Credits returned pursuant to this subsection 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 to the project in an amount equal to or less than the amount of Federal Credits returned by the project to the Committee, in accordance with the revised 9% reservation.

Reason: In the face of unforeseen disturbances in the tax credit markets, staff hopes to help second round 2016 9% tax credit projects close 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. Staff proposes to allow this hybrid structure only for second round 2016 awardees. Almost all first round 2016 projects have already closed, and the few remaining have a March closing deadline which leaves insufficient time.

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 second round 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 by two months. Pursuing a hybrid structure will incur additional delays and likely jeopardize a project's ability to meet both the current readiness closing deadline and the placed in service deadline. Staff will administratively extend the readiness deadlines for projects with May or June closing deadlines that are seeking permission to convert to a hybrid structure until June 30, 2017. Staff has no authority to move the placed in service deadline, however. As an alternative, staff proposes to allow projects seeking permission to convert to a hybrid structure and that are *new construction only* 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, hybrid new construction projects that exchange their credits would have a new placed in service deadline of December 31, 2019.

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.