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DATE: December 22, 2008

TO: Low Income Housing Tax Credit Stakeholders

FROM: William J. Pavão, Executive Director

SUBJECT: Second Set of Proposed Regulation Changes for 2009

Attached for public review and comment are the California Tax Credit Allocation Committee (TCAC) staff's additional proposed regulation changes for 2009. This summary memorandum highlights the additional proposed changes that would go to the Committee for their adoption in February, 2009. The attached changes add to those already released for public consideration and comment on December 10, 2008. In some cases, additional changes are proposed to regulatory sections already proposed for change in the earlier release. In such cases, the attached version has both the original and additional proposed changes highlighted, but the attached statement of reasons only addresses the additional changes. Please consult the December 10 version for the reasons behind the earlier proposed changes.

As noticed earlier, TCAC staff will conduct public hearings to discuss and solicit comments on these and earlier released changes as follows:

Monday
January 26, 2009

Los Angeles
Junipero Serra State Building
320 W. Fourth Street, Los Angeles
7th Floor Conference Room
10:00 a.m. to 1:00 p.m.

Wednesday
January 28, 2009

Sacramento
EDD Auditorium
722 Capitol Mall, Sacramento,
9:00 a.m. to 12:00 noon

Friday
January 30, 2009

Oakland
Elihu Harris State Office Building
1515 Clay Street, Room 2
10:00 a.m. – 1:00 p.m.

In summary, the proposed changes are as follows:

Substantive Regulation Changes:

1. Continue the Difficult to Develop Area (DDA) status in 2009 for eight counties that would otherwise lose that status under federal determinations. For projects in these areas, this change would allow a thirty percent (30%) increase to a project's basis when calculating federal nine percent (9%) Low Income Housing Tax Credits. **Section 10317(d), page 1 of the attached draft.**

2. Increase the competitive Leveraging scoring from 20 points to 30. Points could be garnered through cost efficiency (up to 15 points), public funds (up to 15 points) or credit reduction (up to 5 points). Credit reduction would no longer be mandatory to garner the full 30 points. **Section 10325(c)(1), page 1.**

3. Under Readiness to Proceed scoring, require an executed limited partnership agreement within 150 days of reservation, and require an equity partner Letter of Intent within 60 days of reservation. Also require an enforceable commitment of permanent financing sources within the application. **Section 10325(c)(10), page 4.**

4. Delete the current third tiebreaker, and instead score the highest ratio of public funds to total project costs. **Section 10325(c)(12), page 5.**

5. Require reservation recipients receiving Readiness to Proceed points to pay one-half of the allocation fee within 60 days of the preliminary reservation. **Section 10335(b), page 7.**

Attachment

Additional 2009 Proposed
Regulation Changes with Reasons
December 22, 2008

Section 10317(d)

Proposed Change:

(d) Allocation Priorities. The Committee shall give ~~equal~~ priority when allocating State Tax Credits to applications proposing projects ~~with one or more of the following characteristics:~~

~~(1)~~ not eligible for the 130% basis adjustment, pursuant to IRC Section 42(d)(5)(C)~~;~~. Under authority contained in IRC Section 42(d)(5)(C)(v), for 2009 CTCAC additionally designates projects in the following counties as requiring an increase in credits and therefore considers such projects as being within a difficult to develop area (DDA) as that term is used in IRC Section 42(d)(5)(C)(iii): Alameda, Contra Costa, El Dorado, Napa, Placer, Sacramento, San Joaquin, and Sonoma.

~~(2) HUD HOME program funds are a source of funds, and eligible basis is limited to the amount of unadjusted basis; or,~~

~~(3) HUD HOME program funds are a source of funds and State Tax Credits are needed to satisfy HOME program fund match requirements. The local jurisdiction or Community Housing Development Organization shall provide an explanation why other sources are not available to provide matching funds.~~

Reason:

The proposed changes reflect provisions contained within the federal Housing and Economic Recovery Act of 2008 (H.R. 3221). Specifically, H.R. 3221 discontinued HUD HOME provisions that prohibited such projects from receiving the federal basis adjustment. Therefore, paragraphs (2) and (3) are no longer warranted.

In addition, the proposed language continues for one year the treatment of eight (8) California Counties as difficult to develop areas (DDAs) for purposes of calculating basis and credit reservations. TCAC staff believes this is warranted in light of the late-2008 notice received by California and sponsors of projects in those areas. In addition, under the difficult financial environment likely to continue into 2009, a decrease in the anticipated basis for federal credit calculation purposes further jeopardizes the viability of such projects in the short term. TCAC staff will consider broader applications of its authority under IRC Section 42(d)(5)(v) in future years during 2009.

Section 10325(c)(1)

Proposed Change:

(1) Leveraging Maximum 30 Points

(A) Cost efficiency. A project application for a new construction or an At-Risk development, or a substantial rehabilitation development where the hard costs of rehabilitation are at least $40,000 per unit, whose total eligible

basis is below the maximum permitted threshold basis limits after permitted adjustments, shall receive 1 point, up to a maximum of 15 points, for each percent by which its eligible basis is below the maximum permitted adjusted threshold basis limit. In calculating the eligible basis under this scoring factor, CTCAC shall use all project costs listed within the application unless those costs are not includable in basis under federal law as demonstrated by the application form itself or by a letter from the development team's tax professional.

(B) Credit reduction. A project that reduces the amount of Tax Credits it is requesting shall receive 1 point for each percent that its qualified basis is reduced, up to a maximum of five (5) points. In order to receive points in this category, committed funds must be part of the permanent sources for the development and remain in place for at least ten years.

(C) Public funds. For purposes of scoring, "public funds" include federal, state, or local government funds, including the outstanding principal balances of prior direct federal debt or subsidized debt that has been or will be assumed in the course of an acquisition/rehabilitation transaction, funds from a local community foundation, funds already awarded under the Affordable Housing Program of the Federal Home Loan Bank (AHP), waivers resulting in quantifiable cost savings that are not required by federal or state law, or the value of land donated or leased by a public entity or donated as part of an inclusionary housing ordinance which has been in effect for at least one year prior to the application deadline. Land and building values must be supported by an independent, third party appraisal consistent with the guidelines in Section 10322(i)(4)(A). All such public fund commitments shall receive 1 point for each 1 percent of the total development cost funded, up to a maximum of 15 points.

To receive points under this subsection for loans, loans must be "soft" loans, having terms in excess of 15 years, and below market interest rates, interest accruals, residual receipts payments or other preferred terms for at least the first fifteen years of their terms. Points for donated or leased land shall be calculated based on the lesser of the purchase price or appraised value, except that points for land owned by the public entity for more than three years prior to the application filing deadline shall be calculated based on its appraised value. Further, for points to be awarded under this subsection, there shall be conclusive evidence presented that any new public funds have been firmly committed to the proposed project and require no further approvals, and that there has been no consideration other than the proposed housing given by anyone connected to the project, for the funds or the donated or leased land. Similarly, if the principal balances of any prior publicly funded or subsidized loans are to be assumed in the course of a proposed acquisition, verification of approval of the loan assumption or other required procedure by the agency initially approving the subsidy will be needed to satisfy the commitment requirements.

~~A maximum of 20 points shall be available in combining the cost efficiency, credit reduction, and public funds categories. However, in order to score the full 20 points, at least 2 points must be achieved by each applicant in the credit reduction category.~~

Reason:

The proposed changes would increase the leverage scoring category from a maximum of 20, to a maximum of 30 points. Changes would also (a) eliminate the "credit reduction" requirement and limit points using this option to five (5); and (b) permit points to be earned in both cost efficiency and public funds. Cost efficiency and public funds points would be earned on a straight percentage-to-points ratio. Under the proposed changes, applicants could earn points through a combination of each of the three options, consistent with the point limitations of each factor. Applicants seeking the full thirty (30) leveraging points would be required to maximize both cost efficiency and public funds scores, or supplement that combined score with up to 5 credit reduction points.

Discontinuing the requirement that at least two (2) leveraging points be earned through credit reduction recognizes that not all projects can afford to forgo credit otherwise warranted by a project's basis. Therefore, an applicant could elect not to reduce their credit request and compete without those points.

Additional cost-efficiency language is meant to truly measure a project's development cost-efficiency rather than a voluntary reduction in basis. In recent past competitions, applicants appear to have elected not to include all cost that may be counted as basis in the initial calculation of a project's eligible basis. This competitive behavior is contrary to what this scoring factor is attempting to measure: a project's cost-reasonableness.

TCAC staff rescored second-round 2008 nine-percent credit applications using the proposed scoring changes and learned the following:

Of 101 applications,

- 45 would have earned a full 15 points for cost effectiveness.
- 51 would have earned a full 15 points for public funding.
- Of the 45 cost effectiveness full-pointers, only 20 earned any points at all for public funding.
- Of the 51 public funding full-pointers, only 23 earned any points at all for cost efficiency.
- Only seven (7) of the 101 applications would have earned the full 30 points through cost efficiency and public funding alone.

The similar incidence of full-pointers under the two principal categories indicates that the proposed relative weighting of each factor is correct. That is, one point for each percentage public funds represent of total project costs, and for each percentage a project's basis is below TCAC's limits appears to be the correct weighting.

Of thirty-seven (37) second-round 2008 awards, 10 funded projects would not have been funded under the new proposed system.

TCAC staff continues to analyze the potential systematic impact of these proposed scoring changes, and welcomes a robust public dialog around these ideas. In particular, comments as to whether the proposed scoring scheme would deliver the good public policy outcomes of financially sound, high quality, cost-efficient projects are welcomed.

Section 10325(c)(10)

Proposed Change

~~(10)~~(8) Readiness to Proceed. 20 points will be available to projects that meet ALL of the following, and are able to begin construction within 150 days of the Credit Reservation, as evidenced by submission, within that time, of recorded deeds of trust for all construction financing~~, except for AHP and MHP funds~~, a limited partnership agreement executed by the general partner and the investor providing the equity, payment of all construction lender fees, issuance of building permits (a grading permit does not suffice to meet this requirement) and notice to proceed delivered to the contractor. If no construction lender is involved, evidence must be submitted within 150 days after the Reservation is made that the equity partner has been admitted to the ownership entity, and that an initial disbursement of funds has occurred.

In addition to the above, all applicants receiving any readiness points under this subsection must provide an executed Letter of Intent (LOI) from the project's equity partner within 60 days of the Credit Reservation. The LOI must include those features called for in the CTCAC application. Failure to meet this timeline will result in rescission of the Tax Credit Reservation. The following must be delivered:

- (A) enforceable commitment for all construction and permanent financing, as evidenced by executed commitment(s) and payment of commitment fee(s);
- (B) evidence, as verified by the appropriate officials, of site plan approval and that all local land use environmental review clearances (CEQA and NEPA) necessary to begin construction are either finally approved or unnecessary;
- (C) evidence of all necessary public approvals except building permits; and
- (D) evidence of design review approval.

For paragraphs (B), (C), and (D) an appeal period may run up to 30 days beyond the application due date. The applicant must provide proof that either no appeals were received, or that any appeals received during that period were resolved within that 30-day period to garner local approval readiness points.

In the event that one or more of the above criteria have not been met, 5 points may be awarded for each one that has been met, up to a maximum of 15 points. The 150-day requirements shall not apply to projects that do not obtain the maximum points in this category, for any items for which points are not awarded.

The Executive Director, at his or her sole discretion, may make a finding that a market-wide lack of investor equity or systemic credit market illiquidity warrants a general extension to the 150-day readiness deadline. The Executive Director may extend the deadline at any time for no more than an additional 90 days beyond the original deadline.

Reason:

The readiness scoring factor is meant to competitively favor project sponsors who have completed various development steps prior to application and who commit to completing other specified steps within 150 days of reservation. The listed recordation exceptions

for AHP and MHP, as opposed to other public funding sources for construction are unwarranted. MHP is not a construction period funding source, and AHP contains no unique feature that sets it apart from other construction period funding sources. TCAC does receive applications where AHP is committed at the time of application, and TCAC sees no reason why such committed funding sources cannot close within 150 days.

In addition, some confusion has arisen among program applicants as to whether AHP must be committed at the time of application to garner readiness points. The current regulations provide no scoring forbearance for AHP commitments. The exception from recordation within 150 days has led to the practice of projects with uncommitted AHP financing receiving readiness points. Eliminating the exceptions will also eliminate such confusion in the future.

A proposed paragraph is also added that would require a letter of intent (LOI) from an equity partner within 60 days of the Committee's reservation of credits. This change would help assure that a project is truly prepared to proceed promptly if awarded readiness points. The LOI contents will be listed within the TCAC application, but are likely to include the partnership's name, a development schedule outline, the tax credit reservation amount and terms, including delivery schedule, and more. The content items would reflect industry norms typically found in such LOIs. Leaving flexibility within the regulations would allow TCAC to adjust the content list t reflect changing industry practices.

The new paragraph following paragraph (D) would permit applicants to demonstrate readiness with local approvals still in an appeal period. The proposed rule would award points to projects where an appeal period has run out without appeal within 30 days following the application due date. In such cases, the applicant must demonstrate that any filed appeals were resolved within that 30-day period.

The final new paragraph would allow the Executive Director to extend the 150-deadline by up to 90 days if he/she finds that the equity and credit markets generally are not investing in Low Income Housing Tax Credits. This extremely rare event is occurring in late 2008 and may continue into 2009. Such discretion may permit second-round 2008 projects additional time if the markets do not improve sufficiently to make equity available to those projects. If market conditions continued any longer, the Executive Director would retain the authority to extend deadlines in the greater interest of developing pending meritorious projects promptly, rather than recapturing credits and restarting a development clock with a new sponsor.

Finally, the renumbering change reflects the earlier proposed deletion of subsections (c)(6) and (c)(7).

Section 10325(c)(12)

Proposed Change:

~~(12)~~(10) Tie Breakers

If multiple applications receive the same score, the following tie breakers shall be employed: first, if an application's housing type goal has been met in the current funding

round in the percentages listed in section 10315, then the application will be skipped if there is another application with the same score and with a housing type goal that has not been met in the current funding round in the percentages listed in section 10315; second, only if each of the tied score applications are within a qualified census tract (QCT), the application providing a local governmental letter describing how the project contributes to a concerted neighborhood revitalization plan; ~~for other than Rural set-aside applications, to fund an application for a project located in a qualified census tract or a federally designated Renewal Community, Empowerment Zone, or Enterprise Community or State Enterprise Zone that has demonstrated that it will contribute to a concerted neighborhood revitalization plan, as evidenced by a score of at least eight (8) points, or a project not located in such an area that has received nine (9) points under section 10325(c)(6) or (7) of these regulations;~~ third, the highest ratio of public funds, as described in Section 10325(c)(1)(C), to total project development costs. ~~the application with the lowest ratio of requested unadjusted eligible basis to total residential project costs, excluding developer fee, total land cost, general partner/sponsor equity/loans or loans from the equity provider.~~ This ratio must not have ~~increased~~ decreased when the project is placed-in-service or negative points will be awarded, and the Tax Credit award may be reduced.

Reason:

The proposed change simplifies the current three-tiebreaker. The first change modifies the second tiebreaker by evaluating, for QCT projects only, whether a local governmental official has provided a written description of how the project will contribute to a neighborhood revitalization plan for the area. Such a preference is required by federal law (IRC Section 42(m)(1)(B)(ii)(III)). This change also reflects the proposed elimination of the Neighborhood Revitalization and Balanced Communities scoring factors (see proposed change to Sections 10325(c)(6)(and (c)(7) above).

In addition, the proposed change would eliminate the current third tiebreaker, and replace it with a comparative evaluation of permanent public financing committed to the project. The more competitive applications would have a higher ratio of permanent public funding dollars to total development costs than its competitors. For example, a project wherein committed public funds represent forty percent (40%) of the total development costs would beat a competing project wherein public funds represent 35% of that project's costs.

The new proposed tiebreaker would more directly reward applicants who have local governmental support for their project, including monetary support. This scoring factor would more directly measure the extent to which a project sponsor maximized leverage, while eliminating many of the dysfunctional practices spawned over time by the current third tiebreaker. The proposed tiebreaker would also discontinue competitively rewarding costlier projects. Finally, the proposed final tiebreaker would reward projects with public funding sources, including local sources, who frequently take the lead in resolving performance and other issues as they arise during a project's life. This public funding presence is an additional benefit to the State.

Section 10335(b)

Proposed Change:

(b) Allocation fee. Every applicant who receives a reservation of Tax Credits, except tax-exempt bond project applicants, shall be required to pay an allocation fee equal to four percent (4%) of the dollar amount of the first year's Federal Credit amount reserved. Reservations of Tax Credits shall be conditioned upon the Committee's receipt of the required fee paid by cashier's check made payable to the Committee prior to execution of a carryover allocation or issuance of tax forms, whichever comes first. Preliminary reservation recipients receiving any competitive readiness points under Section 10325(c)(8) must pay one-half of the allocation fee within 60 days of the preliminary reservation, and the balance as described above. This fee is not refundable.

Reason:

The proposed change would encourage a project sponsor to determine a project's true viability promptly by requiring an earlier nonrefundable payment of a project's allocation fee. When coupled with an executed Letter of Intent (LOI) as described in Section 10325(c)(8), this provision would competitively reward those projects that are truly ready to proceed as evidenced by a prompt LOI and fee payment. Should a sponsor not perform as described in the proposed change, TCAC would recapture the reserved credits and reserve them for a waiting list project or in the subsequent funding round as described in regulation.