MHP Draft Guidelines
Statement of Reasons

This document describes the rationale behind significant proposed changes to the Multifamily Housing Program (MHP) for funding authorized by Proposition 1 of 2018, and highlights topics on which the Department of Housing and Community Development (Department) is particularly interested in receiving comments.

The proposed changes are reflected in the draft MHP guidelines, available at www.hcd.ca.gov, with deviations from the regulations applicable to previous MHP funding shown in strikeout and underline format.

Section 7301(d) – Definition of "Chronically Homeless"

The proposed definition is based on that used for Measure HHH funding in Los Angeles. It includes some categories not included in the established federal definition of this term. The Department is interested in comments on this subject, especially on the categories not included in the federal definition.

Section 7301(f) – Definition of "Coordinated Entry System"

This definition is the same as that used by No Place Like Home (NPLH).

Section 7301(h) – Definition of "Eligible Households"

This definition is proposed for revision because the rules of the federal low-income housing tax credit program have been revised to allow eligibility for households with incomes exceeding 60 percent of area median income (AMI), while Proposition 1 and the statutes governing MHP restrict eligibility for this program to 60 percent of AMI.

Section 7301(k) – Definition of "Frail Elderly"

The proposed definition is being added to clarify the status of projects that serve elderly residents who need significant assistance to live outside of institutional settings. The intent is to make it clear that projects of this nature qualify as "Special Needs," and are eligible for application scoring points on this basis. Comments are invited on the adequacy of the definition.

Section 7301(l) – Definition of "Homeless"

This is the same as the definition of this term used under MHP's Supportive Housing component (SHMHP}, funded through previous bond measures.

Section 7301(s) – Definition of “Rental Housing Development”

This term is added to make it clear that the statutory definition applies, rather than that found in the UMRs.

Section 7301(w) – Definition of “Restricted Unit”

The referenced UMR definition points to the low-income housing tax credit program, which was recently changed to recognize units restricted at levels above 60 percent of AMI. By statute, MHP cannot assist these units. Since no assistance is being provided, the Department is proposing to not treat them as restricted units – to not include them in scoring and similar calculations.

Comments are invited on excluding these higher income units. The reason for doing this is to avoid discouraging incorporating them in MHP projects, and thereby facilitating rehabilitation of occupied buildings, increasing the feasibility of including deeply targeted units, and providing housing for a group that still faces affordability challenges, even though their incomes are above the levels directly served by MHP. The Department does have some concern, however, that this exclusion may lead to favoring projects with higher income level units over those that do not have these units. A project with a significant number of 80 percent AMI units, for example, may be feasible at a lower level of average affordability than one without these units, if the 80 percent units are excluded from the average affordability calculation, and even though the overall affordability of the whole project may be less.

Section 7301(v) – Definition of “Special Needs”

The proposed revision is intended to make it clear that elderly residents who need substantial assistance to live outside institutional setting do qualify as a Special Needs group.

Section 7302(b) – Use of Tax Credit Equity

The added text clarifies that a portion of the tax credit equity generated by an MHP project cannot be diverted to another development.

Section 7302(d) – Eligibility of 9 Percent Tax Credit Projects

To maximize utilization of the state’s 4 percent resource, allow MHP projects to proceed expeditiously, and avoid over-heating the competition for 9 percent credits and over-subsidization of 9 percent projects, the Department proposes to continue its historic policy of restricting the combination of MHP funds with 9 percent tax credits to projects with a high percentage of supportive housing units, and hence a need for exceptionally high subsidy amounts. The Department is especially interested in comments on whether the proposed method for doing this – by limiting MHP assistance to projects that qualify

as “homeless assistance projects” under TCAC rules – is the best way to accomplish this objective.

Section 7302(e) – Eligible Project Types

Under the program’s historic scoring system, projects effectively needed to fall into certain project types to score high enough to receive an award. For the MHP Draft Guidelines, the Department is proposing to specify these project types up front, as eligibility/threshold requirements.

Section 7302(e)(1) – Eligible Large Family Projects

In the past, housing need among large families has been particularly acute. For this reason, MHP’s existing scoring system encourages projects with large numbers of three and four bedroom units. Recent census data shows that there remains a substantial population of poor families that need these larger units. However, shortage of units affordable to 50 percent AMI households appears at least as great for smaller households. Also, in the existing MHP portfolio, the number of three and four bedroom units that are under-occupied (using the program’s minimum occupancy requirements) is surprisingly high. In light of this mixed evidence, the Department is proposing to reduce the emphasis on three and four bedroom units, and adopt TCAC’s large family project requirements – 25 percent 3 bedroom and 25 percent 2 bedroom units.

The Department is interested in receiving comments on this subject, and particularly comments based on evidence of need.

There is much evidence that poor families with children do better when they live alongside households who are not poor, and where there are good schools and other resources. For this reason, the Department is proposing that new construction large family projects must either: 1) be located outside of areas designated by TCAC and the Department as “High Segregation and Poverty” or 2) include at least 20 percent of total units either not restricted or restricted at levels above 60 percent AMI.

(Maps of the referenced areas, and details on how they were produced, are available at https://www.treasurer.ca.gov/ctcac/.)

Section 7302(e)(2) – Eligible Special Needs Projects

The 25 percent requirement specified here is lower than the 35 percent needed to garner full scoring points under the existing regulations. The original thought behind the 35 percent number was that it was sufficiently high to confer substantial benefit on the targeted special needs population, and sufficiently low to be consistent with project feasibility and to allow for successful integration with the general public. Now that a 49 percent limit is being proposed on units restricted by the Department to disabled populations (see Section 7302(g)), the Department believes it reasonable to reduce this

requirement, to give sponsors a less narrow range of allowable configurations. It is interested in comments on whether 25 percent strikes the right balance

Section 7302(e)(3) – Eligible Senior Projects

The proposed guideline defines these projects using TCAC's definition.

Section 7302(e)(4) and (f) – Eligible Supportive Housing Projects

Previously, MHP funded supportive housing both as "special needs" projects competing under the "General" program component, and with funds earmarked specifically for this housing type under the "Supportive Housing" component. Special needs projects could receive funding for units serving the general low-income public as well as those restricted to special populations. Beginning in 2012, "Supportive Housing" projects were required to restrict 40 percent of total units to the chronically homeless, with funds limited to units occupied by the homeless. There were separate NOFAs for the General and Supportive Housing components of the program.

The Department proposes to offer funding for supportive housing and other project types under one NOFA. To encourage serving the chronically homeless, this section requires that "Supportive Housing" projects target this population. To promote integration with the general public, and inclusion of supportive housing in large numbers of projects, the draft guidelines require only 15 percent of the restricted units be set aside for this purpose. In the interest of efficient and sustainable supportive service delivery, it further specifies that qualifying projects must have at least ten supportive housing units. The Department is interested in comments on this general approach, and on the specific numerical requirements it is suggesting.

Subsection (f) establishes requirements for projects funded as Supportive Housing. It is based on the requirements applicable to supportive housing funded under the Veterans Housing and Homelessness Prevention program and the NPLH Program.

Section 7302(e)(5) – Eligibility of At-Risk Projects

This section is a work in progress, with comments appreciated. It is premised on the notion that scarce state resources should be focused on projects where there is a significant probability of affordably being lost, and not just a theoretical possibility. Section 7202(e)(5)(A), regarding federally assisted projects, is based on a UC Berkeley study of the history of "at-risk" U.S. Department of Housing and Urban Development (HUD) project opt-outs. This study found that relatively few projects deemed at risk under state program rules are actually likely to opt out, and identified project characteristics that predict which ones fit into this category. Section 7202(e)(5)(B) builds on the conclusion of the Berkeley study that financial incentives play a large role in determining whether an owner will opt-out, but is not based on any specific research findings.

The Department has received a suggestion that it let the tax credit program handle at-risk projects, and focus MHP instead on existing affordable projects that need recapitalization but too small to attract tax credit investors, perhaps as measured by the potential amount of equity raised (say, less than $4 million), and cannot be readily packaged with other projects. To target projects of this nature that provide substantial incremental public benefit, one thought was to limit this category to projects that require substantial rehabilitation (maybe at least $60,000 per unit) and that have substantial occupancy by extremely low-income households. Comments on this suggestion are encouraged.

Section 7302(g) – Integration of Persons with Disability

To further the goal of integrating persons with disability with the larger community, in accordance with the *Olmstead* decision, the Department is proposing to apply the same policies regarding integration that it has adopted for No Place Like Home (NPLH).

Section 7302(h) – Multiple Department Funding Sources

As noted below, the Department is proposing to substantially increase per-unit loan limits, for projects not using 9 percent tax credits. A major reason for doing this is to reduce the need to use multiple Department funding sources on the same project. Use of multiple sources adds administrative complexity and costs for the Department and project sponsors. It can delay the development process, and potentially result in over-subsidization. For this reason, the proposed guidelines prohibit use of multiple programs on the same units, and prohibit use of more than two Department sources on any one project. In recognition of the extra costs associated with infrastructure for some infill projects, this rule is not proposed to apply to grants made under the AHSC or IIG programs.

Section 7303(d) – Sponsor Experience Requirements for Special Needs Projects

When MHP began, nearly 20 years ago, there were relatively few sponsors developing special needs housing. To encourage more projects of this type, the Department relaxed normal experience requirements for projects consisting mostly of special needs units. Now there are many more developers active in this arena, so this special dispensation is no longer necessary.

Section 7304(b)(1) and (b)(3) – Eligible Development Costs

The proposed changes codify Department policies on eligible property acquisition costs (which allow sponsors to recoup their expenses, but do not require them to take a loss if market values decrease or permit them to profit from a market uptick) and land lease payments (which can include the discounted present value of future payments).

Section 7306(a) – Construction Financing

The existing regulations include a never-utilized provision allowing program funds to be used as construction-period financing on projects financed by CalHFA, where CalHFA would provide construction oversight Since there are no near-term plans to implement this arrangement, this provision is proposed for deletion.

The Department acknowledges the interest from the developer community in using MHP funds during construction, and thereby reducing construction lending costs. It will be exploring this option in the future.

Section 7306(c) – Subordination Policy

The proposed changes eliminate a conflict with the Uniform Multifamily Regulations, regarding subordination to locality loans. They also make it clear that AHP loans must be subordinated to program loans; this arrangement has never been an issue.

Section 7307(a) – Use of Tax Credit Equity

The change here is intended to make it clear that equity generated by the sale of tax credits for an MHP project cannot be used for another development.

Section 7307(b)(2) – Per Unit Loan Limits

To reduce the need for layering multiple Department funding sources, and in recognition of the relatively large amount of state funding available over the next few years compared to local funding, the Department is proposing to substantially increase per-unit loan limits for projects that do not use 9 percent tax credits. The proposed $150,000 base loan amount is intended to be sufficient to make 4 percent tax credits projects feasible, provided that they have at least a modest level of local subsidy funding and moderate development costs.

Section 7307(c) – Per Unit Loan Limits for Inclusionary Projects

This section addresses projects required to be built as a condition of approval of other development. These projects would be built with developer funds and other resources if MHP was not available, so there is no public policy rationale for making them eligible for the program, except to the extent that program resources result in greater affordability or more affordable units.

Section 7308– Interest Rate Reduction

The revisions to this section implement AB 2562 of 2018, which requires adjustment of Department loan interest rates to avoid certain tax problems for projects receiving low income housing tax credits.

Section 7312(f)(2) and (f)(4) – Transition Reserves

The Department recognizes that the risk of rental subsidy termination is likely no longer be as great as it was when the MHP regulations were initially promulgated, and that the level of risk may vary by subsidy source. For this reason, it is proposing to half the required amount at this time. It is also procuring the services of a consultant to research the history of subsidy terminations, and provide advice on whether its transition reserve requirements should be adjusted. The proposed change allows the Department adjust its requirements based on the consultant's work.

Section 7312(f)(3) – Rent Adjustment Upon Subsidy Loss

Also in recognition of the generally lower risk of subsidy termination, the Department is proposing to allow rents for units covered by project based rental subsidy to increase to a maximum of 60 percent of AMI, should the subsidy be terminated and the increase is necessary to maintain feasibility. This change will allow projects to support larger amounts of private debt, and reduce the need for development subsidies.

Section 7314 – Design Features

The Department believes that economic constraints and reviews conducted by other funding sources adequately guard against lavish building practices, eliminating the need for limits on design. For this reason, it proposes to delete this section.

Section 7316(a)(3) and (c) – Construction Requirements

The Department has not found it necessary or productive to regulate unit density or the content of construction contracts, and is hence proposing to eliminate provisions regarding these items.

Section 7320(b)(1) – Income Levels Used in Scoring Applications

The Department has received several suggestions that it decrease the level of affordability required to successfully compete for MHP funding, especially in high cost areas, including the suggestion that it use the affordability scoring matrix used to score 9 percent tax credit applications, while potentially adding a "Deeply Low Income" category to reward the inclusion of units servicing households at 0-15 percent of AMI, in line with the framework recently developed by Los Angeles County and HUD. It invites comments on this subject, especially those backed by specific evidence.

As noted above in the commentary on the proposed revision to the definition of "Restricted Unit," the Department is proposing to exclude units restricted at levels above 60 percent from consideration when scoring affordability. This may effectively decrease the overall level of affordability of assisted developments.

One suggestion was based on a comparison of the incomes targeted by MHP in 2017 with projected incomes of minimum wage earners in 2023, when the state minimum

wage is scheduled to reach $15 per hour, potentially resulting in incomes for full-time workers that exceed the 2017 income targets. With higher minimum wages, average incomes of households at the bottom of the income distribution may well increase. However, median income (and hence income levels targeted by MHP) will likely increase as well, and it is difficult to predict the relationship between the two over time, so the Department is reluctant to rely on this type of analysis.

Another party suggested that current targeting is associated with financial feasibility issues. If this was accurate, one would expect the existing MHP portfolio to show signs of duress. This does not seem to be the case, based on a preliminary look at the financial performance of existing MHP projects. Median 2016 per unit cash flow, for example, exceeds that of a nationwide pool of tax credit projects surveyed by the CohnReznik accounting firm.

A final report is that currently targeted levels exceed the income levels of homeless households prioritized by local coordinated entry systems. The Department has not verified that this is an actual problem, but is proposing to revise to allow adjustment of income targets if and when this is the case.

Section 7320(b)(2) – Addressing the Most Serious Identified Housing Needs

This application selection criterion is based on the statutory mandate to give favorable consideration to projects that "address the most serious identified local housing needs."

For a variety of reasons, the formulation in the current regulations has not worked as intended, so the current proposal is revise it to encourage: 1) family new construction projects located in a "High Resource" or "Highest Resource" area, as shown on the TCAC/HCD Opportunity Area Map 2) serving seniors with special needs (e.g. frail elderly or homeless) 3) serving homeless persons and 4) projects that result in adding to the affordable stock, with some limited exceptions. All of these project types address serious housing needs. Development in high resource areas and senior special needs and homeless projects are especially challenging, and likely need extra encouragement. Existing affordable projects generally can have their recapitalization needs met through 4 percent credits, and the Department believes that that projects that add new units to the affordable stock, or deepen affordability should have priority for the deep subsidy provided by MHP.

Section 7320(b)(4) – Serving Families and Special Needs Populations, and At-Risk Projects

As described above, in the explanation of proposed changes to Section 7302(e), the Department is proposing to make qualifying as a Large Family, Special Needs, Supportive Housing, Senior, or At High Risk project a threshold requirement, eliminating the need for a graduated scoring system related to these categories.

The Department has received a suggestion that this criterion be modified to give points to developments restricted to seniors, and is interested in input from others on this point.

By allowing senior projects to be considered Supportive Housing if they reserve a modest number of units for the chronically homeless, the proposed guidelines would give senior projects an additional avenue to be competitive, beyond those available in the past. Similarly, the proposed points for senior special needs projects under Section 7320(b)(2) would give an additional boost to projects that serve homeless or frail elderly seniors. The revision to the definition of “Special Needs Populations” in Section 7301 also makes it clear that projects serving the frail elderly qualify for points on that basis. However, these changes would make the typical “vanilla” senior project highly competitive. Under the proposed guidelines, to score highly these projects would have to provide an additional benefit, such as setting aside some units for the frail elderly or chronically homeless persons.

There are two reasons why MHP has historically not prioritized vanilla senior projects. First, these projects have long been favored by local government funding sources, resulting in high levels of production, compared to other project types. Around one quarter of the units assisted by tax credits over the past fifteen years have been restricted to seniors, while only 14 percent of the lower income renter population were seniors, as of the last census. Many more seniors benefit from units in developments that are not age-restricted. The production of tax credit units restricted to seniors has dipped in the last two years, perhaps as a result of declining local funding, but has never dropped below 15 percent, so it appears that this population continues to be well served.

Second, MHP as currently structured assists a large number of seniors, even though it effectively requires seniors-only developments to incorporate special needs units or provide another similar additional benefit. Since 2009, the statutes governing the program have required that the percentage of assistance awarded for units restricted to senior citizens be proportional to the percentage of lower income renter households in the state that are lower income elderly renter households. Seniors also occupy approximately 10 percent of units in the existing MHP portfolio that are not age restricted.

Section 7320(b)(5) – Leverage of Other Funds

Several changes are proposed related to this application scoring criterion.

First, and consistent with the goal of reducing the number of Department funding sources necessary to use on a single project, other Department funds are proposed to be excluded from the leverage calculation, with the exception of grants for infrastructure.

A second revision would more accurately value land donations, by discounting them based on payments required as a condition of the donation.

Finally, the formulas used to score various project types are proposed for revision, with the aim of 1) allowing projects to be competitive while accessing larger MHP loan amounts, thus reducing the need for tapping other state resources 2) incentivizing projects in high resource areas and 3) incentivizing supportive housing, using a formula that takes into account the relative mix between supportive housing and other units.

Section 7320(b)(6) – Project Readiness

The revision to Subsection 7320(a) is intended to encourage supportive housing projects qualifying as “homeless assistance projects” under the TCAC regulations – the only projects permitted to use 9 percent tax credits – in light of the high need for housing for the homeless.

The revisions to subsection 7329(b) and (c) clarify what constitutes approval under CEQA, NEPA, and local entitlement processes, and address the streamlined local approval processes now available under SB 35, AB 2162, housing element law, and local ordinances. The proposal is to give partial points to projects where there is evidence that the project is likely to be approved under a streamlined process, on the theory that this indicates at least some level of readiness. Comments are invited on whether the partial points are appropriate, and on what basis they should be awarded.

Subsection 7329(e) is proposed for elimination because local design review approval is already covered, as it is one element of the local entitlement process addressed by 7329(c).

Section 7320(b)(7) – Adaptive Reuse/Infill/Proximity to Amenities/Sustainable Building Materials

Subject to further legal analysis, it appears that a criterion similar to this one is required by statute, even though the Proposition 1 funds were not appropriated by the Health and Safety Code section referenced in the regulations.

Also, a statutory change occurring after the regulations were last amended requires consideration of sustainable building methods, so these are being added to the list of factors considered here.

The proposed revisions to subsection 7320(b)(7)(B) are aimed at providing more specific guidance on what constitutes and infill site. They are nearly identical to similar provisions in the Department’s Infill Infrastructure Grant program.

The revisions to subsection 7320(b)(7)(C) also provide specific guidance on how to evaluate proximity to amenities, using TCAC’s point system.

The final paragraph implements the statutory direction to consider sustainable building methods, again using the system the TCAC has already developed.

Section 7325(b) and (c) – Reporting

These sections have been added to make it clear that sponsors with units restricted to the homeless must report additional information on tenant characteristics and outcomes. Similar requirements apply to other Department programs serving this population.

<u>Sections 7327 – 7336 -- Rent Write Down Loans</u>

These sections of the regulations governed a never implemented program component. To avoid confusion, the proposal is to not carry them over into the new MHP guidelines.

<u>Sections 7340 – 7347 – Supportive Housing Loans</u>

These sections implemented the statutes governing funds appropriated under previous bond measures specifically for supportive housing. As described above, the Department is proposing to take a different approach to funding supportive housing with these MHP Draft Guidelines, and not administer them separately from the rest of MHP. Accordingly, the regulation sections on the separate supportive housing program are not proposed to be included in the guidelines.