California Housing Partnership
California's Experts on Affordable Housing Finance, Advocacy & Policy

July 24, 2020

Ms. Jennifer Seeger, Acting Director
Division of Financial Assistance
Department of Housing and Community Development
2020 W. El Camino Avenue
Sacramento, CA 95833

Via email to NPLH@hcd.ca.gov

RE: Comments on NPLH draft guidelines

Dear Jennifer:

Thank you for the opportunity to comment on the proposed changes to the guidelines for the No Place Like Home (NPLH) Program that were issued on June 26, 2020. We appreciate your thoughtful process and active solicitation of stakeholder feedback. Our first comment relates directly to the proposed changes. The remainder of our comments suggest additional changes to facilitate the successful implementation of the program.

Section 202(e) Integration. We support the concept of integrating NPLH units within a development and appreciate the Department's interest in clarifying the requirement. However, we find that the proposed language creates additional ambiguity in general and complications for hybrid or phased projects in particular. The proposed language appears to say that NPLH units must be integrated across all phases of a multi-phase project or all components of a hybrid project, even when only one component or phase is receiving NPLH funds as allowed by Section 200(m). This is not possible from a financing perspective, as the non-NPLH phases or components have different income targeting and target population requirements. Nor is it possible from a timing perspective in multi-phased projects. Moreover, in hybrid developments the two portions are separate legal parcels and entities, further inhibiting the ability to spread units between the two components. Including this requirement will preclude hybrid developments from submitting applications. We recommend that the language be limited to hybrid projects in which both components receive NPLH funding. If the Department has some other intention with this language, it is not clear and we would welcome a discussion of how the language could be clarified. We also note that the "notwithstanding" clause in paragraph (3) now needs to refer to paragraph (1) to reflect the renumbering of the paragraphs.

Section 207(f) Transition reserves. As we have expressed in previous letters regarding the Multifamily Housing Program, the Department should eliminate any transition reserve requirement for projects with rental subsidies. In the decades of their existence, no Section 8 contract (PBRA or PBV) or USDA 521 Rental Assistance contract in California has been terminated due to a failure of federal appropriations. These decades of successful experience have substantially altered the capital markets' view of risk posed by subsidy contracts, and it is now commonplace for lenders working in California to structure debt leveraged by Section 8 without requiring capitalized transition reserves. HCD is now a notable outlier in this regard, contributing to higher project costs and greater public subsidies per unit at a time when the state is focused on reducing both of these.

HCD's transition reserve requirement results in the long-term sequestration of capital dollars that should be deployed to produce more affordable units today. Worse still, the value of these large transition reserves may be captured by LIHTC investors when they exit the ownership entity after 15 years. Many investors require payment for their share of all reserves upon exit, even if those reserves are controlled by HCD or other parties and cannot be liquidated. Large transition reserves are a tempting target, and banking capital dollars today to hedge against a risk that has been demonstrated to be remote only for those funds to be paid to an investor years later is not an outcome anyone should seek or abet. We understand that HCD is considering eliminating transition reserves if it can create a transition pool. While we see benefit in a pool, we strongly recommend delinking these two decisions and eliminating the transition reserve requirement immediately.

Section 209(a) and (b) COSR limits. While establishing lower capital loan limits for NPLH projects utilizing 9% tax credits makes sense because they need less gap funding to fund development due to additional tax credit equity, the operating deficits of 9% and 4% developments are similar and therefore should not be subject to different capitalized operating subsidy reserve (COSR) limits. Moreover, the difference was originally created to push applicants towards utilizing non-competitive tax-exempt bonds and 4% credits. Now that CDLAC is competitive, this rationale no longer exists. We recommend that the Department standardize COSR limits consistent with paragraph 209(b) for 4% projects.

In its response to similar comments for the 2019 NPLH guideline changes, the Department stated, "Since the per-unit subsidy limits for capital are increasing this year to conform to MHP, the Department will wait to consider any other changes to the COSR per-unit calculation formula until the impact of increases to the capital limits can be further evaluated." We believe that the time has come and there is no longer any rationale to maintain lower COSR limits for 9% projects.

Section 209 COSR distributions. It has come to our attention in closing NPLH deals with COSRs that the Department intends to provide no subsidy for the first few months of operation prior to the project's first full fiscal year, that the Department will disburse 12 months of subsidy at conversion to permanent financing for the year in which the conversion occurs based on the

Department's underwriting of the project, and in subsequent years to disburse funds only after the audited close of any fiscal year, as opposed to at the beginning of the fiscal year in which the funds will be needed. All of these decisions require owners to cover significant operating deficits over the entire COSR period. This is a very heavy burden for thinly capitalized special needs developments and results in developers having to create a costly additional reserve to cover these lags in HCD distributions. Moreover, this is wholly inconsistent with how CalHFA disbursed COSRs under the Mental Health Services Act (MHSA) Housing program on which NPLH is largely based. We strongly encourage the Department to specify in the guidelines the use of the MHSA COSR distribution model that covers the first few months of operation and disburses funds at the beginning of each fiscal year with a reconciliation at the end of the year (see Sections 6, 8, and 9 of the attached MHSA COSR Agreement). This change is critical to the cost and on-going viability of NPLH projects.

Thank you very much for considering our comments. We are available to discuss our recommendations at any time.

Sincerely,

Richard Mandel
Director of Financial Consulting

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San Diego Region Director

Enclosure