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January 23, 2003

TO: Law and Legislative Committee

FROM: Anne M. Moore, Executive Director

SUBJECT: PROPOSED CHANGES TO THE 9 PERCENT LOW INCOME HOUSING
TAX CREDIT PROGRAM

RECOMMENDATION

The purpose of this report is to inform the Law and Legislative Committee of the City Council of the draft changes in the Low Income Housing Tax Credit program as proposed by the California Tax Credit Allocation Committee (TCAC), and to discuss their possible implications on applications for Franklin Villa, Sacramento Cottage Housing's Permanent Supportive Housing at McClellan Park, and Lemon Hill.

CONTACT PERSONS

Anne M. Moore, Executive Director, 440-1333
Beverly Fretz-Brown, Director of Development Services, 440-1333

FOR LAW AND LEGISLATIVE COMMITTEE MEETING OF - January 23, 2003

SUMMARY

The California Tax Credit Allocation Committee (TCAC) has proposed changes to the regulations governing the 9 percent Low Income Housing Tax Credit Program. Some of the proposals could be detrimental to high priority projects in the City and County of Sacramento.

COMMISSION ACTION

At its meeting of January 15, the Sacramento Housing and Redevelopment Commission was informed of the proposed changes in the tax credit program and staff's responses.

BACKGROUND

The California Tax Credit Allocation Committee has published proposed changes to the 9 Percent Low Income Housing Tax Credit program which, in two significant areas, could diminish the possibility that high priority projects in the City and County of Sacramento could

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obtain a tax credit reservation. The staff's major concerns are summarized below and elaborated in Attachment I to this report.

- Funding statewide setasides (nonprofit, preservation, small developments, and special needs) out of the geographic regions can potentially wipe out the geographic allotment of credit. By reducing or eliminating the amount of funding in the geographic region - because the statewide setasides are funded first - high priority projects applying only for the regional allotment could be passed over. Sacramento County and all its cities have a separate geographic allotment of credit.
- Retreating from a balanced approach between rehabilitation and new construction makes it difficult for acquisition/rehabilitation projects to compete successfully with new construction.

Both of these issues directly affect Franklin Villa's tax credit applications and could impact the McClellan Park Supportive Housing and Lemon Hill applications as well.

Our staff is working with other cities and counties in responding to the proposed changes in the 9 percent tax credit program. The final draft of these proposals should be published next week, and they will be voted on by the Committee on January 29. Unless the Committee decides otherwise, the changes it adopts will take effect immediately and apply to the first round of tax credits in late March 2003.

The voting members of the TCAC are as follows:

The Hon. Philip Angelides, State Treasurer, 915 Capitol Mall, Room 110. 653-2995

The Hon. Steve Westly, Controller, 300 Capitol Mall, Suite 1850. 445-3028

Robert Miyashiro, Deputy Director, Department of Finance (for the Director), State Capitol Building Room 1145. 445-8610

FINANCIAL CONSIDERATIONS

None

POLICY CONSIDERATIONS

The proposed regulations make it more difficult for the City and County to obtain tax credit reservations for those high priority projects that can only apply to the geographic regional allotment. In one important point category, site amenities, the staff believes that new construction is disproportionately advantaged.

On November 7, 2002, the City Council adopted policies governing applications to the 9 percent tax credit program and establishing priorities for Franklin Villa and Sacramento Cottage Housing's permanent supportive housing program at McClellan Park. At its November 20, 2002 meeting, the Council added the Lemon Hill project as the City's priority in the first round of tax credits in 2003.

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If the draft proposals are adopted, staff believes that the Franklin Villa application would be the most jeopardized, since it would apply only for and would exceed the amount of credit in Sacramento's geographic allotment. The McClellan supportive housing proposal and Lemon Hill are at less risk. Lemon Hill will compete in the first round and could be affected by setaside projects' using most of the geographic allotment. The Cottages' supportive housing development at McClellan will apply to the statewide nonprofit housing setaside beginning in the second round of 2003, and if not successful there, would compete for the geographic allotment. Because many of the proposed changes have an impact on one another, these predictions should not be regarded as certain outcomes since there are many unknowns outstanding.

Respectfully submitted,



ANNE M. MOORE
Executive Director

Transmittal approved.


ROBERT P. THOMAS
City Manager

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January 1, 2003

Ms. Jeanne Peterson, Executive Director
CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE
915 Capitol Mall, Room 485
Sacramento, CA 95814

Re: Proposed 2003 TCAC Regulations

Dear Jeanne:

The Sacramento Housing and Redevelopment Agency appreciates the opportunity to comment on the proposed tax credit regulations.

We look to the tax credit program to provide:

- an engine for new construction, creating balanced communities,
- a means to revitalize neighborhoods through rehabilitating its housing,
- a competitive process rewarding reasonable construction costs and verifiable tenant services, and
- a setaside system that allows access to the tax credit program for the community's highest priority projects.

The proposed regulations strengthen TCAC's ability to produce more cost-reasonable developments by reducing basis boosts and closing the credit reduction point loophole that allowed the substitution of state credits and the double-counting of points attributable to increased public funding.

The proposals also provided strong incentives to increase the use of the tax-exempt bond/4 percent tax credit program for 100 percent affordable projects, providing another avenue for raising the equity needed to house low and very low-income households outside of the 9 percent program.

However, we also believe that the draft regulations retreat from a balanced approach between rehabilitation and new construction, particularly in amenity points, and seriously disadvantage high priority projects competing only in the geographic regions. Our specific comments follow.

The Setaside Problem: Applicant Selection for Evaluation (Section 10325 (d))

The draft regulations would fund setasides out of the geographic regions, potentially wiping out the latter's allotment of credit. Because they are funded first, projects competing in the setasides would receive priority over any applicant in the geographic region, regardless of their competitive points. In addition, the proposal funds the setasides out of the geographic allotments without increasing the balance available to the geographic regions and general pool (total federal credit less setasides).

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Notwithstanding, the regulations continue to state all of the following, which cannot hold true if the setasides are taken out of the geographic regions: (1) that in the geographic regions the highest scoring project will be awarded a reservation; (2) that if the project creates an overage, the next funding round will be reduced by that overage amount; and (3) that if an applicant creates a negative amount of either federal or state credit, it will be bypassed for a less competitive project.

If applicants with reservations from the setasides consume all or most of the credit in the geographic region, which is a definite possibility in the Sacramento region, which, if any, geographic applicant gets funded? It appears that if any is funded, its reservation will reduce or eliminate the July 2003 geographic funding round, which in turn raises the question whether a successful applicant in the setaside in that next round can receive a reservation if its geographic region has no allotment.

We believe there is a better way to handle the geographic allotment to ensure that the highest ranked projects get reservations and that the state's priorities are met: establish minimum points for all applications, geographic and setaside alike. This would preserve the ability of developers and local governments to plan and fund their highest priority projects, retaining whatever control they can exercise in a competitive environment.

Comments on Other Setaside Proposals

Preservation. We concur in the proposed reduction of the preservation setaside. We also suggest below, under the basic threshold for minimum rehabilitation costs, that the minimum hard construction cost be raised to \$10,000.

Special Needs. We support the proposed setaside at 2% in place of the additional points given in the current regulations. The new setaside's linkage to the nonprofit/homeless setaside provides additional opportunities for funding special needs projects. We do not believe that both a setaside and additional points are warranted for either SRO or special needs populations.

Setaside for Overages: Clarifications in Section 10315

The draft regulations propose that three percent of the federal credit ceiling be reserved for any overages in the geographic areas because of large projects. The operation of this setaside can mitigate some of the concerns we have raised above, but it is not clear how it will be applied.

Preserving a Balance between Acquisition/Rehabilitation and New Construction

1. Site Amenities:

Acquisition/rehabilitation projects will not be competitive under the proposed point structure for site amenities. Acquisition/rehab projects, particularly those involving neighborhood rebuilding, are where they are – decisions on the need for government intervention are made independently of their distance from an elementary school, grocery, or park. Acquisition/rehab projects are also exceedingly limited in their ability to increase their density to meet the proposed transit-oriented development standard of 25 units per acre. In our experience, the most successful acquisition/rehabilitation projects have had to reduce density to create play areas and community centers and to convert

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units for occupancy by large families, who are already there living in overcrowded and substandard conditions.

The proposed amenity points are more appropriate for new construction. We believe that fairness can be established by the following changes while protecting the Committee's interest in point differentiation among applicants:

- Eliminate the 25/unit/acre requirement for acquisition/rehabilitation projects. The rehab projects we finance are overwhelmingly infill developments in older, poorer neighborhoods, near transit. Yet they could not access the proposed transit-oriented development points because of the density threshold. Moreover, as stated previously, density reductions are generally required to provide for on-site play areas, community rooms or centers, laundry rooms, and larger bedroom units.
- Establish a separate point system for acquisition/rehabilitation projects within the same site amenity categories:
 - For transit-oriented development projects, the distance requirements should be increased by ¼ mile.
 - For parks/community center, public library, grocery store, and pharmacy, the distance requirements for acquisition/rehab projects should be increased ¼ mile or made the same as for rural projects.
 - For public schools, senior center or sheltered workshop, the distance requirements should be increased by ¼ mile.

The service amenity point structure does not create the same inequities between new construction and acquisition/rehab projects. Its menu of possible activities provides applicants with different combinations to achieve the maximum 10 points. We support the request of nonprofit housing and service organizations to allow case managers and service coordinators to receive points similar to those for senior counseling, recognizing that the coordinator may also serve as a member of the property management staff or be a volunteer. In both cases, the services provided may be excellent; it's a question of documentation.

Preserving a Balance between New Construction and Acquisition/Rehab

2. Project Size and Credit Amount (Section 10325 (f) – Basic Thresholds

Reduction of the maximum project size from 200 to 150 assisted units can limit the financial feasibility of large revitalization projects (non-HOPE VI). There are only so many units one can take out of an application in a very low-income area, since market rents are not high enough to carry the cost of construction. Alternatively, carving up projects and extending their tax credit applications over a number of years in order to reduce the number of units in an application only produces enormous holding costs when multiple social and life/safety issues must be dealt with by controlling the whole complex.

We therefore recommend either returning to the 200 assisted unit level or allowing a waiver up to 200 units for unusual circumstances in large neighborhood redevelopment projects pursuant to a specific revitalization plan.

Limiting to \$1.5 million in the maximum annual federal tax credit award per project is, as above, understandable as a method to increase the number of projects funded. The ability to apply for an

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exception mitigates the difficulties it may impose on large revitalization projects. Steering such developments to the mortgage revenue bond program is not possible in those cases where the project's income cannot carry the required tax-exempt debt.

Leveraging (Scoring - Section 10325)

1. Credit Reduction. Cleaning up the credit reduction category is welcome. Applicants should provide evidence of a fully financed project before and after credit reduction so that the Committee can determine where the substitution for credit reduction has taken place. Substituting state credits for those that were "reduced" does not meet the intent of this category since there is no net loss in credits. Similarly, counting points for any increment of public funding that compensates for the credit reduction creates double counting.

Closing these loopholes is one action that can help increase the number of projects receiving credit reservations.

2. Public Funding. We are advocates for points for public funding because of its effectiveness in improving the design, construction, and management of housing for very low-income people.

However, because public funding does not necessarily produce cost-efficiencies in development, we support the proposed changes that limit public funding and cost-efficiency points to 15 each and cap the combination at 20 points. There must be some incentive for cost reasonableness in the tax credit program. This proposal has merit because it does just that while recognizing the value of public funding.

Basis Boosts

We strongly support the proposal to eliminate the majority of exceptions to the threshold basis limits in the 9% program. A number of the exceptions were redundant; for example, buildings with elevators and larger unit sizes were already accounted for in the basis limits. These proposed reductions in basis boosts provide an additional incentive to build more cost-reasonable developments rather than relying on a credit-inflation system as the route to gaining cost-efficiency and/or credit reduction points.

Tie breakers

The use of credit per unit and credit per bedroom is a reasonable compromise, given that the cost of adding a bedroom in a new construction development is not significant but that the availability of that bedroom is.

Rehabilitation Threshold

\$15,000 in hard construction costs represents a moderate level of rehabilitation. We suggest that the replacement of two building systems be also considered within the hard construction cost. In addition, the minimum for at-risk preservation projects be raised to \$10,000; otherwise the projects should be refinanced through tax-exempt bonds and 4% credits.

Tax-exempt Mortgage Revenue Bonds/4% LIHTC Program

We endorse the draft regulation's proposals to increase the feasibility of bond/4% projects serving high levels of low-income persons in high cost areas. Allowing 100% affordable projects to exceed the basis limits by 60 and 80 percent, depending on their location in a QCT or difficult development area, is a very

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smart move for the non-competitive program for those applicants which exceed the threshold basis limits. We hope that it will provide an avenue for funding more projects that otherwise would have competed under the 9% program.

Similarly, initiating a provisional state credit setaside for those bond/4% projects not eligible for 130 percent federal credit (with reversion to the general program if not used) is another funding mechanism for increasing the number of 100 percent affordable developments outside of the 9 percent program. We would urge consideration of projects with no less than 80 percent assisted units.

Thank you again for the chance to comment on these regulations.

Sincerely,



Beverly Fretz-Brown
Director of Development Services