Date of Hearing: April 25, 2018

ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT
David Chiu, Chair
AB 2562 (Mullin) – As Amended March 14, 2018

SUBJECT: Department of Housing and Community Development loans

SUMMARY: Authorizes the Department of Housing and Community Development (HCD) to change interest rates on loans issued to low-income rental housing projects. Specifically, **this bill**:

1) Authorizes HCD to reduce the interest rate on any loan issued to a rental housing development to a rate determined by HCD that is sufficient to cover the costs of project monitoring.

2) Modifies the requirements for HCD to reduce the interest rate on a loan to such a development by:

   a) Repealing the requirement that the development have no other debt with regularly scheduled or amortizing debt service payments;

   b) Requiring HCD, rather than the sponsor, to determine that the HCD loan is not eligible to be treated as debt for federal or state low-income housing tax credit (LIHTC) purposes without a reduction in the interest rate of the loan;

   c) Repealing the requirement that the development have no debt in a senior lien position to HCD's debt;

   d) Repealing the requirement that the development have 35% or more of the total units in the project serving households with income not exceeding 30% of area median income; and

   e) Requiring the change in the interest rate to increase the feasibility of the proposed project and to further the goals and purpose of HCD and the appropriate loan program.

3) Authorizes HCD to change the current interest rate for any HCD loan for which it receives a loan extension request associated with an award of federal or state LIHTC on or after January 1, 2014, to the applicable federal rate (AFR) published by the United States Internal Revenue Service (IRS) and in effect at the time of closing.

4) Specifies that loans that have already received an interest rate reduction from HCD shall not be altered.

5) Makes other minor technical changes.

EXISTING LAW:

1) Establishes the Multifamily Housing Program (MHP) to provide deferred payment loans for the acquisition, construction, or rehabilitation of housing affordable to low- and very low-income families and individuals.

2) Requires MHP loans to be for a term of not less than 55 years and at 3% simple interest with payments due at the end of the term of the loan.

3) Authorizes HCD to reduce the interest rate on any loan issued by the department to a rental housing development to as low as 0.42% per year, or a rate determined by HCD that is sufficient to cover the costs of project monitoring, whichever is greater, if the development meets the following requirements:

   a) The development has no other debt with regularly scheduled or amortizing debt service payments.

   b) The development will utilize LIHTCs.

   c) The sponsor determines that the loan issued by HCD is not eligible to be treated as debt for federal or state LIHTC purposes without a reduction in the interest rate of the loan, and HCD approves the determination.

   d) The development has no debt in a senior lien position to HCD's debt.

   e) The development has 35% or more of the total units in the project serving households with income not exceeding 30% of area median income (AMI).

   f) The new HCD loan will not be used to supplant or replace an existing HCD loan.

4) Authorizes HCD to change the current interest rate for any loan for which it receives a loan extension request associated with an award of federal or state LIHTCs made on or after January 1, 2014, to the AFR most recently published by the IRS. Requires the additional tax credit equity generated by the interest rate change to be used for rehabilitation of the development.

5) Requires HCD to charge a fee in an amount sufficient to cover administrative costs associated with a loan modification requested by a borrower.

FISCAL EFFECT: Unknown.

COMMENTS:

Background: Rental housing developments that are affordable to low- and very-low income families and individuals typically require multiple sources of construction financing. Two key sources of funding are the Multifamily Housing Program (MHP) and the Low-Income Housing Tax Credit (LIHTC). The Tax Credit Allocation Committee (TCAC) administers the LIHTC program and awards credits to qualified developers who can then sell those credits to private investors who use the credits to reduce their federal tax liability. The developer, in turn, invests the capital into the affordable housing project.

MHP provides deferred payment loans ("soft" loans) to developers for the construction of affordable housing to low and very low income residents. All loans are for fifty-five years at 3% simple interest and payments of principal and the accumulated interest are due at the end of the loan period. These deferred loans significantly lower the developer's debt service expenditures, allowing the developer to offer rents at an affordable level to lower-income households.

For such soft loans to be considered a loan and not a grant for LIHTC purposes, however, a project sponsor must be able to demonstrate some plausible set of circumstances under which it could repay the loan. Because MHP loans carry a 3% deferred interest rate, this can create a conflict for projects that receive an MHP loan, reducing the amount of federal tax credits for which such a project can qualify. In some cases, the developer would be liable for a large amount of "exit taxes" once the tax credit investor leaves the partnership after year fifteen, which could put the affordable housing at risk.

In an attempt to address this problem, AB 523 (Ammiano), Chapter 445, Statutes of 2014 gave HCD discretion in limited circumstances to reduce the interest rate on a project that receives an MHP loan and is also awarded a LIHTC. To qualify, a sponsor has to prove to the satisfaction of HCD that without the reduction in the interest rate on the MHP loan the amount of tax credit the project could qualify for would be reduced and there are no other loans on the development that require ongoing debt payments. That bill provided a minimum floor of 0.42% interest per year.

This bill removes the 0.42% minimum interest rate on loans and instead allows HCD to set any interest rate sufficient to cover project monitoring costs. This bill also loosens requirements on development eligibility in order to allow more low-income rental housing projects receiving HCD loans, such as projects in the Affordable Housing and Sustainable Communities Program or the Veterans Housing and Homelessness Prevention Program, to qualify for this interest rate modification. Additionally, this bill permits HCD to increase interest rates on any extended HCD loans to the AFR, which may be needed to preserve project feasibility in some instances where loans are being extended for more than five years or otherwise modified.

<u>Federal tax reform:</u> The 2017 federal tax reform bill, the Tax Cuts and Jobs Act, lowered the corporate tax rate from 35% to 21%. As a result, the value of the LIHTC, which provides a way for corporations to offset some of their federal tax liability, has declined. Though the 2018 federal omnibus spending bill increased LIHTC allocations by 12.5%, experts estimate that the net effect of the two bills will result in a loss of about 204,000 affordable rental homes nationwide over the next decade.[1] In California specifically, the 12.5% increase is worth about $125 million annually over the four-year term of the increase, but the corporate rate change will cause a loss of $500 million per year in LIHTC value on a permanent basis.[2] The modifications in this bill could prevent existing affordable rental housing developments that utilize LIHTC from losing their affordability, and make it easier for future projects awarded LIHTC to maintain affordability.

<u>According to the author:</u> This bill will grant HCD authority to adjust (increase or decrease) the interest rate (if requested by the project sponsor) on any loan from any program for projects that will also be using federal LIHTC to as low as 0.42% to as high as the AFR in place at the time of closing. Local public agencies have been assisting affordable housing development by being flexible in the terms of their affordable housing loans. AB 2562 would enable HCD to provide the same kind of flexibility as local public agencies have. This flexibility will generally result in more equity leveraged from tax credit investors to pay for affordable housing.

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[1] Michael Novogradac and Peter Lawrence, "How Many Jobs, Affordable Rental Homes Each State Would Gain Under FY 2018 Omnibus?," Novogradac & Company, *Notes from Novogradac* (blog), April 4, 2018.
[2] Matt Schwartz, "Spending Bill Increases LIHTC and Affordable Housing Funding for FY2018," *California Housing Partnership Corporation*, March 22, 2018.

Committee amendment:

To better reflect the author's intent to give HCD discretion in implementing this section, the below amendment is proposed:

1. On page 3, in line 17, strike out "shall" and insert, "may"

Related legislation:

AB 523 (Ammiano), Chapter 445, Statutes of 2014: Gave HCD discretion in limited circumstances to reduce the interest rate on a project that receives an MHP loan and is also awarded a LIHTC.

SB 77 (Leno), 2012: Would have given HCD discretion in limited circumstances to reduce the interest rate to as low as 0% on a project that receives an MHP loan and is also awarded a LIHTC. *This bill died in the Assembly Rules Committee*.

REGISTERED SUPPORT / OPPOSITION:

Support

City of San Jose
Corporation for Supportive Housing
LeadingAge California
Non-Profit Housing Association of Northern California

Opposition

None on file

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