SENATE COMMITTEE ON HOUSING
Senator Nancy Skinner, Chair
2023 - 2024 Regular

Bill No:	AB 2638	**Hearing Date:**	6/24/2024
Author:	Ward		
Version:	4/9/2024		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Max Ladow		

SUBJECT: Housing programs: financing

DIGEST: This bill authorizes the Department of Housing and Community Development (HCD) to approve the pay-off of an HCD loan in whole or part, prior to the end of its term, and the extraction of equity from a development for purposes approved by HCD.

ANALYSIS:

Existing law:

1) Allows HCD to approve an extension of an HCD loan, the reinstatement of a qualifying unpaid matured loan, the subordination of an HCD loan to new debt, or an investment of tax credit equity under various older HCD rental housing finance programs. Allows this approval if HCD determines that the project will have after rehabilitation of repairs, a potential remaining useful life equal to or greater than the term of the restructured loan.

2) Allows HCD to charge a monitoring and transaction fee to cover its costs for loan extensions and transactions and requires developer fee limitations to be consistent with specified laws and regulations, including those set by the California Tax Credit Allocation Committee (CTCAC).

3) Provides that HCD may subordinate its loan to refinance existing senior debt only as necessary for project feasibility and to reimburse borrower advances for predevelopment costs, recent capital improvements, and recent operating deficits.

4) Includes, in Multi-family Housing Program (MHP) Regulations, issued by HCD, the following prohibitions:

a) Prohibits a property owner from encumbering or pledging Rental Housing Development, or any interest therein or portion thereof, or allow any lien, charge, or assessment against the Rental Housing Development without the prior written approval of HCD.
b) No loan may be paid-off prior to maturity without the prior written consent of HCD in its sole discretion. This consent shall be subject to conditions deemed necessary to ensure compliance with the Program requirements.

5) The Loan Portfolio Restructuring Program includes the following prohibitions on cash payments to program sponsors:

a) Project sales from involving a cash payment to the selling party, or to any party related to or affiliated with the selling,
b) Property owners cash out their equity.

This bill:

1) Authorizes HCD to approve the pay-off of an HCD loan in whole or part, prior to the end of its term, and the extraction of equity from a development for purposes approved by HCD.

2) Allows a housing sponsor to use a loan and equity payments for all of the following eligible uses: the purchase of a limited partner interest of a tax credit investor in the project, payment of any unpaid deferred developer fee for the project, payment for necessary repairs and rehabilitation of the project, and the establishment or replenishment of HCD-approved project reserves.

3) Allows HCD to subordinate its loan to refinance existing senior debt for eligible activities listed under (2) and to reimburse advances for predevelopment costs, capital improvements, and operating deficits, only if HCD's security is not jeopardized, as determined by HCD. Also allows HCD to approve additional senior debt, as specified, and to consider information from third-party capital needs assessment reports in this additional debt approval.

4) Prohibits the extension, reinstatement, subordination, payoff, extraction, or investment, as specified, if it would result in a rent increase for tenants of a development over the annual adjustment to the tenants' rents under HCD's regulatory agreement.

5) Authorizes HCD to charge additional fees, as necessary, to cover its costs for processing restructuring transactions, and provides that the monitoring fees continue until the end of the term of HCD's regulatory agreement, as specified.

6) Limits developer fees that may be paid from equity payments from a restructured loan to the amount allowed by CTCAC and to 25% of actual rehabilitation costs, as applicable.

7) Authorizes HCD to waive specified requirements in the regulatory agreement if a loan is paid off, including requiring occupancy and financial reports and governing the use of operating income and reserves for the development.

8) Provides that any extraction of equity from a development is subject to being shared with HCD in an amount determined solely by HCD, but not greater than an amount proportionate to the amount of the HCD loan secured by such project to the total construction costs of the project.

9) Prohibits HCD from limiting the amount a housing sponsor may spend on supportive service costs paid as operating expenses, except as follows:

   a) The cost of staff supervision shall not exceed 10% of the cost of onsite staff salaries; and
   b) Administrative overhead expenses, including accounting and human relations, shall not exceed 15% of the total supportive services costs paid as operating expenses.

COMMENTS:

1) *Author's Statement.* "Affordable housing developers are challenged with accessing enough funds to break ground and develop essential, affordable housing. Often, they have to access various sources of funds, including loans from HCD. However, when affordable housing developers access these loans, they are locked in and do not have any flexibilities. Under existing law, HCD has the authority to approve any prepayment of affordable housing loans; however, HCD has indicated that it will not currently approve any adjustments to its loans. Allowing affordable housing projects to sell or refinance HCD loans will provide additional funds for the development of desperately needed affordable homes in California. AB 2638 will require, under certain conditions, HCD to allow the sales and refinancing of HCD financed properties, unlocking millions of dollars by allowing repayments or partial repayments of HCD loans. Any sale or refinancing of HCD loans would include an agreement that the affordable housing development remains affordable for the duration of the original loan period, ensuring the preservation of affordable housing."

2) *Affordable Housing Finance.* The state finances affordable multifamily rental housing using a combination of loans, tax credits, and private activity bonds. Unlike market rate housing, affordable housing does not have the cash-flow from rents to support traditional financing.

   Affordable housing is provided to tenants whose household income is below the area median income (AMI). To qualify, very low-income tenants must make 60% or less of the AMI and lower-income tenants must make only 80% or less of AMI. Tenants in affordable housing are only required to pay 30% of their income toward rent, so the state needs to provide enough long-term subsidy to reduce the overall debt service on a development. HCD loans serve as the permanent financing that comes in once a development is complete to take out the predevelopment and construction loans a developer took on to construct the development. HCD loans are secured with a lien in first position on the property. Developments are also subject to a 55-year recorded regulatory agreement which runs with the project. If a developer pays off an HCD loan before the covenants expire, the regulatory agreement is not extinguished and the developer must continue to provide the units at an affordability rent for the length of the regulatory agreement to lower-income tenants.

3) *HCD Prepayments and Equity Withdrawals.* Developers with older HCD loans would like the option to sell developments with MHP loans and pay off the loans or to refinance the loans to take cash out to pay developer fees, rehabilitate a development, or re-deploy the funds to develop more affordable housing. This could generate millions of dollars to create new affordable housing.

   MHP regulations suggest that HCD does have some discretion to allow for prepayment and limited ability to allow for a refinance of a loan. HCD may allow refinancing of existing liens or additional financing secured by the development maintain or improve the fiscal integrity of the project, to maintain affordable rents, or to decrease rents. HCD can also agree to a MHP loan being paid off prior to maturity.

   HCD also administers the Loan Portfolio Restructuring Program (LPRP). This program was appropriated $332.5 million to preserve and rehabilitate existing HCD-funded developments, including those with MHP loans. To qualify, developments must have expired regulatory agreements or the regulatory agreements must be set to expire by 2032. The LPRP does not allow cash payments to the developer or any cash-out of their equity except if the cash payment is held in a restricted account, contributed to the project during the development period, and remains with the project as permanent funding.

This bill would authorize HCD to approve the pay-off of a department loan in whole or part before the end of its term and the extraction of equity from a development for purposes approved by HCD. Any modification to the loan or equity payment to the developer cannot result in in a rent increase for tenants of a development over and above the annual adjustment to the tenants' rents under the HCD's regulatory agreement. These core components of the bill have significant influence on affordable housing financing flexibility: how much equity a developer can take out of a project will impact rents levels for the length of the 55-year regulatory agreement, as well as the amount of equity available to maintain the development.

4) *Supportive Services*. The MHP program provides loans to permanent supportive housing developments that provide both housing and supportive services to people experiencing homelessness. The loan is long-term and an equity investment in the development which keeps the rents at very low or extremely low levels. When an applicant applies for a loan, they can request funds to capitalize the operating reserves, or additional funds that are provided to support the supportive services and staff to provide supportive services for the development. HCD currently caps the amount of operating reserves that can be dedicated to supportive services. This bill would require HCD to eliminate the cap in regulations governing MHP. Using MHP funds to fund supportive services reduces the overall amount available for constructing affordable housing; however, it is a necessary trade-off as there are very limited long-term funding sources available for supportive services for supportive housing.

RELATED LEGISLATION:

AB 515 (Ward, 2023) — would have required HCD, to the extent permitted under federal law and the California Constitution, to allow prepayment of any loans related to housing or housing projects administered by HCD, as specified. *This bill was held in the Senate Appropriations Committee*.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: No

POSITIONS: (Communicated to the committee before noon on Wednesday, June 19, 2024.)

SUPPORT:

California Council for Affordable Housing (Sponsor)
California Housing Consortium

California Housing Partnership Corporation
Eden Housing
Housing California
LeadingAge California
Resources for Community Development

OPPOSITION:

None received.

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