

Notes from Meeting with Bill Pavao 02.19.09 Regarding the Stimulus Package

Stimulus funds available:

HOME funds allocated according to the HOME formula translates into estimated \$325 million for CA which can be used to assist 2007, 2008, and 2009 tax credit projects, either 4% or 9%.

Exchange of Credits for cash at 85 cents per credit dollar for up to 40% of the 2009 allocation amount and any unused 2008 or 2007 credits. 40% of the 2009 credits at 85 cents comes to about \$300 million for CA.

General mechanism for use of either form of subsidy:

Pavao indicated a leaning toward lending the money in a deferred loan, rather than a grant, because the deed of trust provides an additional enforcement mechanism. Funds used to substitute for credits could be forgiven after the compliance period. Funds used in conjunction with credits would need to be structured to be compatible with credits, and agreements for local HOME funds could be used as guidelines/precedent/example.

TCAC will need to contract with an agency/private entity to underwrite the projects where cash is being substituted for credits, because there will not be investors analyzing and vetting the projects. Cal HFA is one possibility. CDFI's such as Enterprise, LIIF, and LISC were suggested as another possibility. More information is to be provided to TCAC regarding CDFI's. The ones which are attached to tax credit syndicators would have the most appropriate experience and capability.

Assistance to 2008 and 2007 projects:

There appears to be no reason not to "monetize" any and all unused credits from 2008 and 2007.

Invest in/lend each of the 2008 (and 2007, if any) projects that have not found investors cash equivalent to the lesser of the amount of equity in the respective project's TCAC application, exiting partnership agreement or 85 cents on the credit dollar. The reason for the lesser of is to avoid windfalls to 2008 projects and to encourage developers to take private investor deals if they can get them.

If there are 2008 projects unable to proceed even with monetized credits, use the trade-in funds that would have applied to those projects for unsold 2008 4% projects or new 2009 projects. Consensus was not to give the unsold 2008 projects additional funding from the HOME allocation in addition to swapping cash for credits. Concern is to avoid depressing the syndication price and not to make it too easy for syndicators/investors to back out on partnership agreements or otherwise committed deals.

Use of 2009 monetized credits

Very strong consensus on the following parameters:

1. TCAC should set clear categories of projects that would have priority/be eligible for these monies. Homeless, rural, small project, special needs were unanimously deemed to be categories that are being dropped by the private investors and

should therefore get the cash infusion. Pavao said Central Valley projects also cannot get investors. Also mentioned were rehabilitation projects that had less than gut rehab and expiring use projects. There was general agreement that these three groups of projects also are having trouble getting investors, so should be eligible for cash, though maybe of lesser priority than the others.

2. Set clear deal points in advance such as cents on the credit dollar, pay-in schedule, and reserve requirements.

It may be possible to offer less than 85 cents. Avoid making the cash deals so much better than the credit deals that every developer will want cash even when they could get investors. The idea would be to peg the monetized price roughly equivalent to what the investors are paying on the regular credit deals.

Even though contributing the cash during construction would achieve significant savings that would enable spreading the money over more deals, Pavao is disinclined to get TCAC into the construction lending business. His initial preference is to invest/lend 20% of the money up front and the rest at project completion. However, developers pointed out that many equity deals involve a great deal more than 20% of the equity being contributed during construction (though often after the project is 50% completed) and that it may not be possible to get large enough construction loans to cover the difference. If the larger loans are possible, they will add to the cost of the projects. In addition, TCAC could rely on the private banks and/or other public lenders to monitor construction, as many private equity investors do.

3. Developers with projects in the eligible categories for monetized credits, should be able to demonstrate inability to obtain private equity by including in their application a narrative of the efforts they made to market the project to investors.
4. Whichever agency/private contractor(s) TCAC uses to underwrite the mission should be constrained to reviewing only particular issues and specific due diligence items, and there should be deadlines for completing the work to enable the projects to go ahead expeditiously.
5. Selection of projects should stick to the adopted QAP with as few changes as possible to adjust for the new sources of funds.
6. There was some concern that recipients of monetized credits would score less well on the third tie-breaker. Pavao noted that most of these – e.g., rural, 100% homeless projects- would primarily be competing against other monetized projects, so this would be less of a problem than thought. Additionally, he noted that he wanted such projects to work to obtain more public and private funding, rather than relying on credits, which is the thought behind the third tie-breaker.

Use of the HOME funds:

Since the Treasurer has now made it clear that there is unlikely to be money available to honor MHP and other State housing program commitments for about a year or more, a very important use of the HOME money should be to “backstop” the MHP and other HCD programs. The group presented its priority list of state housing funding putting those projects that are complete and ready to convert at the top of the

list, then under construction, then shovel ready with 9% allocations, then shovel ready with 4% allocations, then those in predevelopment.

It is essential that this money not substitute permanently for the HCD program funds, but serve as a bridge source for each project until CA is able to sell enough bonds to fund the respective project and pay back the HOME funds. A list of So. Cal HCD projects indicates that about \$58 million will be needed for the already complete projects, which will grow to about \$100 million within a year. This list is not comprehensive and does not include Northern CA. The group agreed to work together try to get a complete list from HCD.

Ways to backstop the MHP

Since bridging the HCD loans would require a large percentage of the HOME funds, the group explored some other options. All agreed, however, that it is absolutely essential that none of the state program projects be allowed to go into foreclosure because of CA's inability to fund. Letting any of these projects go under would have horrible consequences not only for the specific projects and their developers but for banks and investors, confidence in housing programs in general and long term viability of all housing programs in CA.

Pavao suggested paying the additional interest carry costs to keep the finished projects on their construction loans until the state has funds. This idea may work in many cases, but there are problems that need to be taken into account with this possibility:

1. Certain project costs such as developer fees and reserves are pegged to conversion to perm loan, so staying on the construction loan for an additional year puts serious stress on the developer and may leave some necessary project costs unfunded. Possibly these problems could be overcome by getting all of the HCD approvals and documents in place and putting them in escrow so that the only condition to closing is funding and then renegotiating the partnership agreements and other soft loan documents to recognize that this step is equivalent to perm closing and therefore enables them to release the funds that were due to be released at perm loan closing.
2. The private takeout loan commitments have expiration dates, and banks may not be willing or able to hold them open indefinitely. Consequently by the time the MHP is ready to convert the project may have lost its private takeout commitment or the lender may change the terms significantly. In the current market banks are shying away from term debt, so that the private takeout loan component may be difficult to replace and/or may only be replaceable on terms that leave a funding gap. Like #1 above, possibly the lenders could be convinced to close/convert the private term loans if all MHP-related conditions are removed.
3. Most of the MHP's are funded with tax-exempt bonds. These bonds have repayment deadlines, which may be easy to extend or may be very expensive and difficult, some extensions may require reissuance of the bonds. In any case there will be extension fees (on the non-bond issue deals as well as the bond issues). In some cases there will also be significant additional costs of issuance. Extensions will have to be worked out case by case with each lender/bond purchaser.

4. The lack of confidence in the state will have to be addressed to induce private lenders/bond holders to extend. HCD will have to provide a strong and clean assurance that within the time of the extension the state will have enough money to fund the loans.
5. Sitting on the construction loans, ties up bank funds that would otherwise be available to fund new projects. Delaying paying off these construction loans exacerbates the current credit shortage.
6. The project cannot apply for its 8609 under current TCAC procedures until the permanent loans are closed. There will be issues with the investors' tax returns if the project goes on too long without the 8609.

Many MHP projects are ready to start, but without firm estoppels and agreements from HCD lenders won't lend and investors won't invest, so the projects are in limbo. Projects that are shovel ready might be able to close and get under construction if the HOME money were used to guarantee the MHP (or other state program funds). Assisting the MHP's that would be under construction now but for the state freeze has the advantage of helping projects that are more ready to go than probably any of the projects that will submit in the upcoming 9% round. It also buys time, so that if the state is able to sell enough bonds within a year or two, hardly any of the HOME funds would actually have to be disbursed for this purpose. The question is, how much of the guarantee would have to be collateralized? The answer will depend on HCD's plans and the Treasurer's forecasts for likely bond sales. Many in the group felt that even if backstopping these MHP's uses all of the stimulus HOME funds, it will be the best possible use of funds, and the funds could be released/recycled within just a few years.

A number of developers have MHP projects which have 4% tax credit allocations and bond allocations, that now can't close. Based on what was said at the PMIB, these developers are probably going to return these awards and then apply for 9% credits in the upcoming rounds. Some of these projects are for supportive housing, and would be able to use the MHP in conjunction with the 9% credits. Even if TCAC is unable to guarantee/bridge all the MHP's it should consider backstopping the MHP 9% deals, because this would enable the projects to apply for a much lower amount of credits/monetized credits, thus enabling TCAC to fund more projects. Even though Pavao said TCAC would not question readiness for a project with an MHP commitment, realistically, without a guarantee/bridge of the MHP such a project will not be able to close its loans within the readiness time frame and will ultimately have to return its allocation.

Issues with HOME funds:

1. Davis Bacon applies. Not a problem for shovel ready MHP's, because they are already paying state prevailing wage, and many already have other federal funds in them that require Davis Bacon as well. Need to check whether it is a problem for already completed projects that did not use Davis Bacon in construction. General belief is that there is a provision that if the HOME funds were not committed before the project was completed, Davis Bacon would not apply.

If HOME funds are used for non-MHP/HCD deals, the additional Davis Bacon requirement may add significant cost, unless the HOME funds can be attributed to 11 or fewer units.

2. NEPA applies. Need to check whether it is a problem for already completed projects that did not have any previous federal funding and so did not comply with NEPA. General belief is that there is a provision that if the HOME funds were not committed before the project was completed, the project would be exempt. Shovel ready projects that did not have previous NEPA clearance would have to comply and would need time to do so.

For non-MHP projects and MHP's with no previous NEPA clearance would TCAC be the lead agency?

3. The use of HOME funds for projects that already have local HOME funds committed to them would put the aggregate HOME funding over the program per unit funding limits in many cases. TCAC would have to get a waiver of the per unit limit, which appears possible in the language of the legislation.
4. Would the money paid back to TCAC when HCD funds its program loans be considered program income and therefore be available to fund additional projects? If so, backstopping HCD programs would enable the HOME funds to be recycled relatively quickly and substantially increase the benefit of this funding.
5. Is there a HOME timing problem with the use of current HOME funds for '06 deals, as is the situation with projects waiting for MHP permanent conversion?

Timing:

Pavao will meet with user groups and come out with a set of proposed regulations in March. Then TCAC will take comments. Given the time for this process the earliest meeting at which these regulations could be adopted would be in May. Therefore, TCAC is likely to delay the first 9% application round until the end of May.

The preference is to adopt the QAP that is currently scheduled for adoption and then make amendments as necessary to accommodate the monetization and HOME funding from the stimulus package.