



Department of Housing and Community Development

Affordable Housing Innovation Fund (SB 586 Dutton) *Affordable Housing Revolving Development and Acquisition Program*

The "Loan Fund" Proposal

Introduction – Invitation

The Department of Housing and Community Development (Department) is in the process of developing a revolving loan fund to be used for loans to affordable housing developers for the acquisition of real property for the development or preservation of housing affordable to low-income households. The Department will choose a Fund Manager to manage the Loan Fund.

This is not a Request for Proposal. The Department will be issuing a Request for Proposal to select a Fund Manager at a later date.

This document represents a draft proposal of the form that this loan fund will take. You are invited to review this proposal and to participate in fine tuning the fund's final form. Your company/group has been invited to participate because you have been identified as a stakeholder in this effort.

Join us at a meeting in Rancho Cucamonga at:

**Goldy S. Lewis Community Center
11200 Base Line Road
Rancho Cucamonga, CA 91701
919-477-2782
The Big Horn Room
Tuesday, May 12, 2009
1:00 p.m. – 4:00 p.m.**

**If you can attend or if you have any questions, please contact;
Peter Solomon, Program Manager
916-324-1484 or:
psolomon@hcd.ca.gov**

The Scope and Purpose
“Golden State Acquisition Loan Fund”

One of the major impediments to the development and preservation of affordable housing in California is the lack of ready access to capital for the acquisition of property. The need is for loan funds available at a high enough loan limit to purchase sites as they are available with an attractive rate, term and LTV to make projects workable and a speedy process from application to close to be able to react to the market.

To help address this fundamental funding need in the affordable housing development chain, the California legislature passed SB 586 (Dutton, Chapter 652, Statutes of 2007, excerpt attached), the Affordable Housing Innovation Fund, which included the Affordable Housing Revolving Development and Acquisition Program (AHRDAP). The AHRDAP includes two funds, the Loan Fund and the Practitioner Fund.

This proposal is part of the development of the Loan Fund, tentatively called ***“Golden State Acquisition Loan Fund”*** (the Fund).

As described in the statute (Health and Safety Code § 50705 et seq.), the Department will choose a Fund Manager to manage the Loan Fund. The Department will enter into an agreement with the Fund Manager and will disburse funds to the Fund Manager which will be used as a portion of the Project Loans made to developers.

The Process

This upcoming meeting is the first step in the Department’s development of the Loan Fund. The process will proceed as follows:

- Stakeholders, non-profit lenders and affordable housing developers, meeting to explore proposed Loan Fund
- Based on outcome of stakeholder meeting and other input, the Department develops final Loan Fund proposal in the form of Guidelines and a Request for Proposals (RFP) to be used in the selection of the Fund Manager and management of the Loan Fund.
- RFP released and proposals received
- Staff review of proposals
- Division recommendation of Fund Manager selection
- Presentation of Fund Manager selection to Loan and Grant Committee for recommendation
- Department decision on Fund Manager
- Agreement developed and executed with Fund Manager
- Loan Fund open for business

The following represents a draft outline for the Loan Fund. This includes statutory requirements and additional detail developed to describe the Fund's operation. Also, included are the qualifications and criteria for the selection of the Fund Manager, the general form of the loan from the Department to initially capitalize the fund, and a description of the project loans made from the fund to affordable housing developers.

Comments are provided to serve as topics for discussion during the stakeholders meeting.

The Fund Manager – Threshold Requirements

These requirements for Fund Manager candidates are found in § 50706 of the Health & Safety Code. All Fund Manager applicants must meet these eligibility thresholds:

- Non-profit lender with experience making acquisition and predevelopment loans for affordable housing in California.
- Originated and serviced loans in the aggregate amount of not less than thirty million dollars (\$30,000,000) that were used to develop or acquire affordable housing, including at least ten million dollars (\$10,000,000) in acquisition loans.
- Have at least twenty-five million dollars (\$25,000,000) of its own capital invested in loans to affordable housing developers similar to applicants for Loan Fund Project Loans. **(How do we best define this?)**
- Be the originator of loans in the aggregate amount of twenty-five million dollars (\$25,000,000) or more using bank or other investor capital.

H. & S. Code § 53545.9(a)(2) states that twenty-five million dollars (\$25,000,000) be made available for the Loan Fund. The statute requires that this \$25,000,000 be leveraged 3:1 with funds from other sources. This means that each Project Loan will include no more than 25% funds from the Department. The additional 75% of each loan could be provided by the applicant/developer from other sources, but we believe this requirement undermines the effectiveness of the Fund.

The Loan Fund, as proposed by the Department, requires that the Fund Manager capitalize the Loan Fund with the required 3:1 leverage. This means that the Fund Manager will be required to provide commitments of at least seventy-five million dollars (\$75,000,000) of funds to capitalize the Loan Fund.

Fund Manager Selection Criteria

To assist in making the selection from among multiple Fund Manager candidates, the Department has developed several criteria that will be used in rating and ranking the applicants.

- Applicants will be ranked according to the amount of capital they propose to make available for Project Loans from the Loan Fund. Seventy-five million dollars (\$75,000,000) is required as a minimum commitment. Candidates will be placed in rank order based on amount of funds committed.
- Cost to borrower: Applicants will be ranked based on cost of funds proposed to be charged to borrowers for Project Loans, taking into account both the interest rate and fees . The lower the cost the higher the ranking.
- Experience and Capability: Applicants will be ranked based on the measure of their experience (dollar volume and number of loans) making loans for property acquisition in affordable housing projects. Financial capability information will be required to be provided and will be reviewed.
- The proposed business plan will be reviewed and evaluated.

The Draft Plan

The Fund Manager

- A Single Entity is welcome to apply. Single Entity applicant must meet the statutory threshold requirements and must bring a commitment of seventy-five million dollars (\$75,000,000) in loan capital to the Loan Fund.

Fund managers consisting of multiple entities are also eligible. A possible model of a Fund Manager applicant could be a:

- Consortium
 - LLC or other configuration
 - All members of the consortium are Originating Lenders and provide loan capital.
 - Number of members TBD by lender interest and manageability concerns **(3-6 possible?)**
 - One of the members serves as the Senior Participating Lender, the remaining members serve as Originating Lenders.
 - The Senior Participating Lender provides a fund commitment equivalent to 55% to 65% of loan fund's total assets, or fifty-five million dollars (\$55,000,000) to sixty-five million dollars (\$65,000,000) **(exact percentage to be proposed by applicant).**

- Model with Senior Participating Lender
 - **The partner with the significantly larger capital commitment to the fund has the senior underwriting role as it takes the largest portion of each loan deal. This allows the other lender-partners to serve as originating lenders for loans in their sphere of activity (affinity, geography, project or applicant type) with a smaller commitment of funds. The Senior Participating Lender can also serve as an originating lender.**
- The Senior Participating Lender in a proposed consortium must meet the statutory threshold requirements for experience and capacity

Model of participation shares in each Project Loan (sample):

- State of California - 25%
- Originating Lender - 10% - 20%
- Senior Participating Lender - 65% - 55%

The ratio is 3:1, consortium participation to State participation. This covers the statutory requirement of 3:1 leverage of the loan fund assets in each Project Loan.

The proposed scenario for loan capital commitments requires the Senior Participating Lender to commit 55% - 65% of the funds total assets (\$55,000,000 to \$65,000,000) and the smaller special purpose partners (the other Originating Lenders) to commit a minimum of, as an example, five million dollars (\$5,000,000). They would participate as originating lenders until their capital was completely committed and then they would sit out until those loans were repaid and their capital pool was replenished (or they brought additional capital to the pool). The total capitalization of the fund would need to be some agreed-upon percentage above the seventy-five million dollars (\$75,000,000) in Fund Manager provided capital required to leverage the state's twenty-five million dollars (\$25,000,000).

Fund Manager Compensation

The fund manager may receive compensation in the form of loan fees and/or spread between the interest rate paid by the fund manager and the rate paid by the developer / borrower. Compensation levels will be subject to Department approval, and must be reasonable in comparison with that received by managers of other similar funds.

The Fund Manager is responsible for:

- Reviewing and approving loan applications
- Originating and servicing loans

- Establishing terms and conditions for loan applications

The Fund Manager must present a detailed business plan describing how the entity intends to meet the Loan Fund requirements, including:

- Plans for marketing the Loan Fund to prospective customers
- Appropriate financial and internal controls
- Underwriting standards and procedures
- How the lender will close loans quickly

The Loan

- Twenty-five million dollars (\$25,000,000) loaned to the Fund Manager (loan agreement with Department)
 - Disbursed in two draws, first draw at signing of loan agreement; second draw one year after first draw if an agreed-upon percentage of the first draw has been committed to Project Loans. The Department will consider advancing second draw sooner if the first draw has been committed to Project Loans.
- Funds disbursed to the Loan Fund, but not disbursed as Project Loans are deposited in an interest bearing account to fund the loan loss reserve.
- Loan term is five years, but can be extended in 5 year increments **(Discussion topic)**
 - **Without longer term, it is hard for this to truly be a revolving loan fund since Project Loans are also 5 year term (max), and**
 - **Project Loans come due after the end of the five year Loan term to Fund Manager**
 - **Possible solution to this dilemma:**
 - **Extend contract for 5 years at the end of the 2nd year of the initial contract if certain agreed upon milestones are reached.**
- Interest: 2% - 3% simple interest paid annually on funds disbursed as Project Loans.
- Loan Funds not lent by the Fund Manager after 48 months of availability shall be disencumbered and transferred to the Department for use in the CalHome Program.

The Project Loans

- Eligible applicants are non-profit or for-profit housing developers, or governmental entities that also operate as developers, that meet the following statutory requirements:
 - Support of local government for the proposed development project (letter OK)

- Sufficient organizational stability and capacity to complete the proposed development project. (Shown through prior success of similar projects, or through other means acceptable to the Department)
 - Completion of not less than five housing development projects with not less than 40 percent of the units affordable
- Originating Lenders: Eligible applicants apply to one of the originating lenders in the consortium. Documentation to be used is determined and supplied by Originating Lender with any additional documentation as required by the Fund Manager. With a Single Entity serving as the Fund Manager, the applicant applies directly to the Fund Manager.
- Uses:
 - **Acquisition of real property for the development or preservation of housing affordable to low-income households.**
 - Projects can be rental or homeownership.
 - All rental developments must have at least 50% of total units restricted to occupancy by households with incomes at or below 50% of AMI, adjusted by household size, with rents not exceeding 30% of 50% of AMI.
 - The Department will overlay funding targets beyond “affordable to low-income households.” These targets will be measured against the entire loan fund portfolio, see “Funding Decisions.” The targets are:
 - Income targets – 20% of funds for loans to projects restricted to households at or below 50% AMI (area median income).
 - Geographic distribution targets – 45% of funds to Southern California and 30% of funds to Northern California
 - Rural targets – 10% of funds to rural projects
 - Loan may also include costs for predevelopment associated with property acquired with the Project Loan.
 - Loan can include capitalized loan interest costs and fees.
- Standard underwriting criteria will be developed for the Fund’s Project Loans to include items listed below as Project Loan terms and conditions and requirements for:
 - Reporting
 - Sponsor Concentration
 - Payback extensions
 - Milestones
 - Appraisal requirements
 - Equity requirement (no equity required, but costs through predevelopment must be covered)
 - Development plans

- Evidence of appropriate zoning
 - Insurance
 - Environmental requirements
- Maximum LTV:
 - 95% for for-profit borrowers
 - 125% for non-profit borrowers.
 - **Is this still possible in the current lending environment?**
- Maximum Loan Amount:
 - \$5,000,000 of which a maximum of \$750,000 may be for predevelopment costs. **(Is \$5 million enough?)**
- Term:
 - Maximum of five years per statute – Department preference is for a maximum three year term with possible extensions not to exceed five year statutory maximum.
- Rate:
 - Determined by originating lender, subject to Department approval. (Target rate of 6 ½% to 7% works in the market)
- Interest Reserve:
 - 100% of loan interest is capitalized at closing into an interest reserve.
- Fees:
 - Determined by originating lender, not to exceed 2% and subject to Department approval.
- Loan Loss Reserve:
 - The state funds advanced to the Fund Manager will be placed in an interest-bearing account(s) by the Fund Manager. The interest earned will be the first level coverage of the risk to cover losses from loan defaults.
- Funding Decisions:
 - Made by a credit committee that includes representatives of the Originating Lender and the Senior Participating Lender. The Department has a staff advisory role.
 - The Fund Manager will be responsible for managing the fund to achieve the geographic distribution, rural percentage and income targets listed above. Performance in meeting these targets will be measured prior to receiving the second draw of Department funds, and at specified intervals thereafter.

- When the Fund Manager has received more Project Loan applications that pass threshold requirements than funds available, the applications will be ranked by the level of affordability of the proposed housing units with those affordable to the lowest incomes ranked first. The remainder of the applications will be ranked in order of affordability. Loans will then be made to projects with highest rank first until all funds have been disbursed. ***(This provision, along with the income targets and limits on rental projects discussed above, is intended to implement the statutory mandate to give priority to projects with the greatest affordability. Is there a better way to do this?)***
- Applicant must execute a regulatory agreement with the Department guaranteeing the long-term affordability of the project's housing units.

Join the Department in developing this important new resource to assist in the development and preservation of affordable housing in California.

Excerpt from Loan Fund Authorizing Statute

BILL NUMBER: SB 586 CHAPTERED
BILL TEXT

CHAPTER 652
FILED WITH SECRETARY OF STATE OCTOBER 13, 2007
APPROVED BY GOVERNOR OCTOBER 13, 2007

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INTRODUCED BY Senator Dutton
 (Principal coauthor: Senator Correa)
 (Coauthors: Assembly Members Emmerson, Ma, and Saldana)

FEBRUARY 22, 2007

An act to add Section 53545.9 to, and to add Chapter 8.5 (commencing with Section 50705) to Part 2 of Division 31 of, the Health and Safety Code, relating to housing, making an appropriation therefor, and declaring the urgency thereof, to take effect immediately.

LEGISLATIVE COUNSEL'S DIGEST

SB 586, Dutton. Affordable Housing Innovation Fund: Affordable Housing Revolving Development and Acquisition Program.

Existing law, the Housing and Emergency Shelter Trust Fund Act of 2006, authorizes the issuance of bonds in the amount of \$2,850,000,000 pursuant to the State General Obligation Bond Law.

Proceeds from the sale of these bonds are required to be used to finance various existing housing programs, capital outlay related to infill development, brownfield cleanup that promotes infill development, and housing-related parks. The act establishes the Housing and Emergency Shelter Trust Fund of 2006 in the State Treasury and requires the sum of \$1,500,000,000 to be deposited in the Affordable Housing Account, which the act establishes in the fund. The act continuously appropriates the money in the account in accordance with a specified schedule that requires, among other things, the transfer of the sum of \$100,000,000 to the Affordable Housing Innovation Fund, which the act establishes in the State Treasury, to be administered by the Department of Housing and Community Development and expended for competitive grants or loans to sponsoring entities that develop, own, lend, or invest in affordable housing, and to create pilot programs to demonstrate innovative, cost-saving approaches to creating or preserving affordable housing.

This bill would establish the Affordable Housing Revolving Development and Acquisition Program under the administration of the department. The bill would authorize applicants under the program to apply for loans to purchase real property for the development or preservation of housing affordable to low-income households and would require applicants to demonstrate certain qualification factors. The bill would require the department to adopt guidelines and regulations establishing the minimum criteria required of the fund manager and applicants, as well as a point system for prioritizing requests in the event that requests exceed the funds available for

the program in any given year. The guidelines and regulations would give priority to applicants who can demonstrate specified criteria.

The bill would require the department to issue a request for qualification to select a private sector entity to manage the Loan Fund. The bill would establish criteria that the fund manager must meet and would also require applicants for the fund manager position to submit a business plan that addresses appropriate financial and internal controls as well as a description of how the lender would close loans quickly.

The bill would require the funds in the Affordable Housing Innovation Fund to be allocated in the amount of \$50,000,000 for the Affordable Housing Revolving Development and Acquisition Program, of which \$25,000,000 would be made available to the Loan Fund and \$25,000,000 would be made available to the Practitioner Fund; \$5,000,000 for the Construction Liability Insurance Reform Pilot Program, which this bill would establish within the department; \$35,000,000 for a local housing trust fund matching grant program established under a specified provision of existing law; and \$10,000,000 for the Innovative Homeownership Program, which the bill would require the department to develop and implement as specified. The bill would make an appropriation by authorizing the funds in the continuously appropriated fund to be expended for these additional purposes.

The bill would require the department to grant preference to a housing trust fund that agrees to expend more than 65% of state funds to a specified first-time homebuyers' program and to set aside funding for a specified 36-month period for newly established housing trust funds that are in a county with a population of less than 425,000 persons when awarding the \$35,000,000 under the local housing trust fund matching grant program. The bill would also require the department to make available 50% of this grant money exclusively for newly established housing trust funds.

This bill would declare that it is to take effect immediately as an urgency statute.

Appropriation: yes.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. (a) The Legislature hereby finds and declares that the Housing and Emergency Shelter Trust Fund Act of 2006 allocates the amount of one hundred million dollars (\$100,000,000) to the Affordable Housing Innovation Fund established in the State Treasury under subparagraph (F) of paragraph (1) of subdivision (a) of Section 53545 of the Health and Safety Code and states that the expenditure of those funds is subject to the enactment of a subsequent statute approved by a 2/3 vote of each house of the Legislature.

(b) Accordingly, it is the intent of the Legislature in enacting this act to program the funds made available under subparagraph (F) of paragraph (1) of subdivision (a) of Section 53545 of the Health and Safety Code from the Affordable Housing Innovation Fund.

SEC. 2. Chapter 8.5 (commencing with Section 50705) is added to Part 2 of Division 31 of the Health and Safety Code, to read:

CHAPTER 8.5. AFFORDABLE HOUSING REVOLVING DEVELOPMENT AND ACQUISITION PROGRAM

50705. (a) The Affordable Housing Revolving Development and Acquisition Program is hereby established for the purpose of funding the acquisition of property to develop or preserve affordable housing. The program will be comprised of a Loan Fund and a Practitioner Fund.

(b) The department shall adopt guidelines and regulations for the operation of the program and may administer the program under those guidelines for 24 months after the date of adoption of the guidelines. The guidelines shall not be subject to the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code.

50706. (a) (1) The department shall issue a request for qualification to select a private sector entity to manage the Loan Fund for a period of five years, and the agreement may be extended in additional five-year increments. The selected fund manager shall be responsible for reviewing and approving loan applications, originating and servicing loans, and establishing terms and conditions for loan applications. The fund manager shall meet all of the following criteria:

(A) Be a nonprofit lender with experience making similar loans in this state.

(B) Have originated and serviced loans in the aggregate amount of not less than thirty million dollars (\$30,000,000) that were used to develop or acquire affordable housing, including at least ten million dollars (\$10,000,000) or more in acquisition loans.

(C) Have at least twenty-five million dollars (\$25,000,000) of its own capital invested in loans to affordable housing developers whose characteristics are similar to the criteria the fund manager will be implementing under the new gap acquisition fund.

(D) Be the originator of loans in the aggregate amount of twenty-five million dollars (\$25,000,000) or more using bank or other investor capital.

(2) Applicants for fund manager shall submit a detailed business plan describing how the entity intends to meet the requirements of the Loan Fund. The business plan shall include a description of appropriate financial and internal controls and underwriting standards and procedures. The plan shall also demonstrate how the lender will close loans quickly.

(b) Applicants may apply to the fund manager for loans to purchase real property for the development or preservation of housing affordable to low-income households. Loans made under this section shall be for a maximum term of five years.

(c) Applicants shall demonstrate all of the following:

(1) The support of the local government in which the real property is located for the proposed development project. Support may be demonstrated through a letter from the governing board or the manager of the housing or community development department.

(2) Availability of additional funds equal to three times the loan amount.

(3) Sufficient organizational stability and capacity to carry out the proposed development project for which the property is being purchased. Capacity may be demonstrated by substantial successful experience performing similar activities, or through other means acceptable to the department.

(4) Completion of not less than five housing development projects, with each project having not less than 40 percent of the units sold at an affordable housing cost, as defined in Section 50052.5, or

rented at an affordable rent, as defined by Section 50053.

(d) The guidelines and regulations, at a minimum, shall do all of the following:

(1) Establish the minimum criteria required of the fund manager and applicants.

(2) Establish a point system for prioritizing requests in the event that requests exceed the funds available for the program in any given year.

(3) Give priority to applicants that propose development projects with the greatest level of affordability.

(4) Provide that any equity not originally contributed by the borrower shall return to the state for the purposes of this program if the property is sold or transferred for purposes other than affordable housing.

(5) Establish a reasonable fund manager administrative fee.

(e) Funds not lent by the fund manager within 48 months after availability to the fund manager shall be disencumbered and transferred to the Self-Help Housing Fund established under Section 50697.1, to be expended for the purposes of the CalHome Program established under Chapter 6 (commencing with Section 50650).

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