REFINANCING AND SYNDICATING/RE-SYNDICATING OLDER HCD-FUNDED PROJECTS: RECOMMENDATIONS FOR CHANGES

December 1, 2011

The Issue

From 1980 to 1995, HCD administered a variety of programs to finance affordable multifamily housing, the Rental Housing Construction Program – Original (RHCP-O), the Rental Housing Construction Program-Bond (RHCP-Bond), the Family Housing Demonstration Program (FHDP), the California Housing Rehabilitation Program – Rental (CHRP-R), the Special User Housing Rehabilitation Program (SUHRP), and the Deferred Payment Rehabilitation Loan Program (DPRLP). Projects developed under these programs are now 15-30 years old and are beginning to need to refinance and/or syndicate/resyndicate. However, some of the legal rules and policies associated with these programs make recapitalizing these projects difficult.

Although much of the older HCD portfolio is in good condition, after 15 - 30 years of operations there has been substantial wear and tear on a number of properties. Programs such as CHRP-R, SUHRP, and DPRLP funded the rehabilitation of buildings that were already old 15 or 20 years ago - and sometimes did not do sufficient rehab. In addition, the special needs populations and large families that these buildings serve also result in intense usage of the facilities.

HCD would much prefer to see recapitalization occur without increasing the amount of private debt, because higher debt means increased risk and will often necessitate rent increases. However, other sources of funding are often insufficient. The replacement reserve balances for many projects are far below the levels required to cover needed capital improvements, and local government funds are increasingly scarce. Many projects lend themselves to syndication under the Low Income Housing Tax Credit program, which brings new equity into the project, but the equity generated is often insufficient by itself to cover the rehab needs of the property, replenish reserves and pay transaction costs.

In order to refinance debt and/or add equity, new lenders and investors require the HCD financing to be subordinated and to be extended to at least the same term as the new debt or equity, often out to a new 55 year term. This typically requires HCD to extend its loans for 10 to 20 years. No new money is requested from HCD, just an extension of the term and longer deferral of the interest. A new infusion of capital can be brought in from the private sector to extend the useful life of the affordable units at no additional cost to HCD.

Proposal for Recapitalization Terms

To develop a framework for efficiently recapitalizing older HCD projects, a group of nonprofit developers and consultants with substantial numbers of HCD portfolio units (BRIDGE Housing, Eden Housing, Mercy Housing California, Mid-Peninsula Housing, and Community Economics, Inc.) has been working with HCD since last spring to try to find a better way to recapitalize the older HCD properties. The matrix shown on the second sheet in this workbook constitutes a consensus (with a couple of noted exceptions) on the part of these nonprofits and HCD staff on the rules that should govern these recapitalization transactions. These recommendations are now being distributed for input from the rest of the affordable housing community.

Proposed Rules for Projects Financed Under Old HCD Programs being Refinanced, Syndicated or Re-syndicated				
12/1/2011 Outline Draft				
	RHCP - Bond	**FHDP**	**CHRP - R**	**DPRLP, SUHRP & RHCP-O**
Basic Underwriting -- patterned after HCD's Uniform Multifamily Regulations				
- residential vacancy assumption	5% unless a different amount required by another funding source or supported by compelling market evidence.	same	same	same
- commercial vacancy assumption	Based on the operating history of the project.	same	same	same
- operating expenses	Based on operating history + TCAC minimums.	same	same	same
- debt service coverage	No limit for projects not requesting special rent increase. For projects requesting a special rent increases, DSC of 1.1 to 1.2, except may be higher in order to ensure 15 years of positive cash flow or first-year cash flow equal to 12% of operating expenses.	same	same	same
- balloon payments on senior debt.	Prohibited, except during periods with documented difficulty in obtaining fully amortized loans on reasonable terms.	same	same	same
- variable interest rate on senior debt	Underwritten based on ceiling rate.	same	same	same
- 15 year positive cash flow	Required using TCAC trending assumptions.	same	same	same
- rents upon subsidy termination	Rents below 50% AMI may be raised to a maximum of 50% AMI.	same	same	same
Developer Fee	If special rent increases are required, net fee (gross - GP capital contributions) is subject to the limits on fee includable in basis under the 9% tax credit program, plus the amount TCAC would allow for commercial space. Otherwise all fees are based on the restrictions from the new financing sources.	same	same	same
Reserves	Required replacement reserve deposits will be sized based on projected costs over 20 years, adjusted for inflation and as shown in a reputable third party replacement reserve analysis.	same	same	same
HCD Debt Service -- HCD Position	HCD position: To cover HCD's monitoring costs, we need some level of required payments. For RHCP-Bond, we propose setting them at 0.42% of the original principal balance, upon loan extension, syndication or subordination to new senior debt. They may be paid upfront, with the amount based on the present value of the full remaining term.	Same as for RHCP-Bond	Same as for RHCP-Bond	Same as for RHCP-Bond, except that for loans with principal amounts under $15,000 per unit the payment amount will be based on the principal balance plus accrued interest.

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HCD Debt Service -- Bay Area Developer Position	Bay Area developers position: No required debt service if the loan is assumed without changing any terms. New debt service is due on extended increment of loan term only (not including the original term) and based on original principal balance (not accrued interest). May be paid upfront (NPV) or over time.	same	same	same
Subordination	HCD will subordinate to new conventional debt if the sponsor demonstrates the new debt is needed for improvements as demonstrated by third party reports, and without regard to LTV.	same	same	same
Required Rehab	As justified by a reputable third party needs assessment.	same	same	same
Special Rent Increase	If needed to support new debt to do work supported by a 3rd party PNA, rents may be increased up to the originally promised AMI levels (35% and 50% AMI) upon turnover. Rents for existing tenants may be increased no more than 10% per year up to the originally promised AMI levels. Future increases are based on annually published AMI levels.	same	Per SB 707 Guidelines, rents may be increased such that 35% of units are at MHP B level with the balance no higher than 60% AMI. Shallower targeting is possible where necessary to maintain fiscal integrity. OR: Rents may be increased up to 50% and 60% levels, based on the original income restrictions.	Per SB 707 Guidelines, rents may be increased such that 35% of units are at MHP B level with the balance no higher than 60% AMI. Shallower targeting is possible where necessary to maintain fiscal integrity.
Limitation on Special Rent Increase for Existing Tenants	10% per year.	same	same	Maximum of 10% per year OR: Maximum of the lesser of 10% per year or amount needed to bring rent up to 30% of household income (Existing SB 707 provision).
Income Limits	Upon turnover, reset income limits to match rent limits. E.g., when a unit with a 35% AMI rent becomes vacant, it would be filled by a tenant with an income of 35% of AMI or less (vs. the current 50% AMI limit).	Same concept -- income limits would match rent limits.	Same concept -- income limits would match rent limits.	Same concept -- income limits would match rent limits.
HCD Loan Extensions	Increased term available for ten or more years resulting in a new loan term of no more than 55 years (or longer if necessary to match expiration date of tax credit restrictions).	same	same	same
Uses of Sales Proceeds by Seller	Limited to repaying existing hard debt and sponsor advances used for predevelopment costs, emergency repairs, operating deficits, and similar costs.	same	same	same

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Owner structure	In addition to typical limited partnership structure, LLC GP with 79% sponsor control and 21% unaffiliated control is acceptable. So-called "4 layer" structures are acceptable.	same	same	same
Uses of Surplus Cash	Deferred developer fee, allowable partnership and investor fees, then per UMRs (50% to sponsor, 50% prorata to soft lenders). Adjust formula if necessary to avoid reduction in payments currently made on HCD loan. Bay Area Developers: also allow as a priority payment sponsor distributions consistent with original agreement. Don't adjust to avoid reducing HCD payment.	Deferred developer fee, allowable partnership and investor fees, then per UMRs (50% to sponsor, 50% prorata to soft lenders).	Deferred developer fee, allowable partnership and investor fees, then per UMRs (50% to sponsor, 50% prorata to soft lenders).	Deferred developer fee, allowable partnership and investor fees, then per UMRs (50% to sponsor, 50% prorata to soft lenders).
Tenant Notices	Discussion of 12-month notice requirement.	same	same	same
Eviction Notices	Discussion of eviction notices to include referral to local legal services office, and copy sent to HCD.	same	same	same
Annual Operations Audit	Already required	Already required	Annual operations audit required. Exception: small projects where not previously required.	Annual operations audit required. Exception: small projects where not previously required.
Group Homes	Not applicable	Not applicable	Not applicable	Separate, simplified rules for small group homes requesting loan extensions.