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MEMORANDUM FOR: Senator Nancy Skinner, Chair, Committee on Budget and Fiscal Review
Assembly Member Philip Ting, Chair, Committee on Budget

FROM: Jennifer Seeger, Deputy Director
Division of State Financial Assistance

SUBJECT: Foreclosure Intervention Housing Preservation Program Progress Report

The Foreclosure Intervention Housing Preservation Program (FIHPP) was added to California's Health and Safety Code in July 2021 as part of AB 140. The Budget Act of 2021 appropriated $500 million for the program. The purpose of FIHPP is to preserve affordable housing and promote resident or nonprofit organization ownership of residential real property.[1] Funds are to be made available as loans or grants to eligible borrowers to acquire and rehabilitate properties at risk of foreclosure or in the foreclosure process.[2]

Health and Safety Code section 50720.2, subdivision (b)(5) states: "Not later than May 15, 2023, the department shall report to the chairs of the Assembly Committee on Budget and the Senate Committee on Budget and Fiscal Review on the implementation of this program, including the amount of funding disbursed and number, location, and cost of acquired properties, as well as the number of units acquired." This memorandum serves as that report.

Executive Summary

Currently, the California Department of Housing and Community Development (HCD) is solidifying the operational foundation of this complex program. While funding has yet to be disbursed, key program components (e.g., legally binding guidelines, a Request for Applications to solicit prospective fund managers) are now in place to fully implement the program. HCD anticipates that all fund managers will be selected in 2023 and will be ready to accept applications from potential project sponsors in early 2024.

[1] Health and Safety Code section 50720.2.
[2] Health and Safety Code sections 50720.2 and 50720.8.

Unique Program Elements

FIHPP's focus on a unique class of projects and its dissimilarity to existing programs required HCD to develop largely unprecedented program components, policies, and controls to ensure that the program is functional and responsibly managed. The FIHPP statutory requirements presented the following challenges:

- The FIHPP statutes require HCD to grant funds to one or more fund managers (nonprofit lenders or housing trust funds) to implement the program.[3] Based on HCD's experience working with external fund managers on the Golden State Acquisition Fund, HCD designed a tiered program organization that placed HCD at the top to disburse funds to an Administering Fund Manager (AFM) that, pursuant to a grant agreement with HCD, will then carry out program specifics according to legal requirements.[4] The AFM will be responsible for disbursing funds to implementing fund managers (IFMs); monitoring each IFM's project portfolio; and collaborating with IFMs on, among other things, the development of uniform underwriting criteria and legal documents.[5] Under its subcontract with the AFM, each IFM will do all of the following:
    - In collaboration with the AFM, implement a qualification process for the sponsors that will acquire and rehabilitate properties with program funds[6]
    - In collaboration with the AFM, develop consistent loan and grant application forms, application review criteria, and standard forms[7]
    - Approve or reject loan and grant applications and disburse funds[8]
    - Monitor sponsors and their projects through project stabilization,[9] manage loan repayments, and enforce legal documents[10]

- FIHPP funds must be used to acquire and rehabilitate 1-25 unit residential real properties that are not currently being operated as regulated affordable housing and that are at risk of foreclosure. No other existing HCD program serves projects with these characteristics. Most HCD programs primarily fund new construction of new regulated affordable housing units. One program, the Golden State Acquisition Fund,[11] supports acquisition of property for affordable housing but has been used almost exclusively for acquisition of vacant land. Another program, the Portfolio

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[3] Health and Safety Code section 50720.6, subdivisions (a) and (c).
[4] Foreclosure Intervention Housing Preservation Program Final Guidelines, section 201 (Jan. 4, 2023). All further references to guidelines are to the foregoing unless otherwise indicated.
[5] Guidelines, section 306.
[6] Guidelines, sections 405 subdivision (a)(1) and 501.
[7] Guidelines, section 405.
[8] Guidelines, section 405, subdivision (b)(2) and (4).
[9] Guidelines, Appendix A, subdivision (uu).
[10] Guidelines, section 405, subdivision (b)(7)-(10).
[11] Chapter 8.3 (commencing with Section 50705) of Part 2 of Division 31 of the Health and Safety Code.

Reinvestment Program,[12] funds rehabilitation of existing properties but is targeted only to currently regulated affordable housing projects in HCD's portfolio.

- To work as envisioned, FIHPP must provide multiple types of financing—predevelopment, acquisition, and long-term gap financing—in one program.[13] FIHPP also offers funding for related costs, such as a project's capitalized operating subsidy reserve, replacement reserve, and specified transaction costs.[14] Most HCD programs provide only one type of financing, usually long-term gap financing.

Program Development Process

FIHPP's unique tiered structure and innovative class of eligible projects, as described above, require an innovative new program design with breadth and complexity to promote both flexibility and accountability. The program development process was multi-phased to ensure a legally sound program consistent with statute. The required approach took time but promises to reap significant demand for program funds-- and serve as a national model.

Extensive cross-division collaboration within HCD – across the program, legal, contracts, and budget divisions – enabled the Department to successfully problem-solve the many operational aspects of the program. This collaboration brought to light that there were statutory changes needed to allow for successful implementation of the program. **In 2022, two trailer bills were enacted to effectuate the statutory changes needed to operationalize the program, including changes to the division of responsibilities between HCD and the fund managers, and changes affecting the mechanics of transferring funds from HCD to the fund managers** The need for statutory changes delayed program implementation by several months.

The requirement to use external fund managers to implement the program also impacted the timeline as it necessitated several extra steps that other HCD funding programs do not require. HCD will release a Request for Applications (RFA) directed to AFM candidates, allow for responses to that RFA, select an AFM, and enter into a contract with the AFM. The AFM will, in turn, enter into contracts with IFMs. Each of these steps raised novel factual and legal issues that required consideration and problem-solving.

Furthermore, in order to provide prospective fund managers with a clear scope of work for what FIHPP implementation will entail, HCD needed to adopt intelligible and

[12] Chapter 5.5 (commencing with Section 50606) of Part 2 of Division 31 of the Health and Safety Code.
[13] Guidelines, section 503.2, subdivisions (c) and (d); Guidelines section 503.6(b).
[14] Health and Safety Code section 50720.8, subdivision (a)(2); Guidelines section 503.2, subdivisions (f) and (g); Guidelines, Appendix A, subdivision (c).

comprehensive FIHPP Final Guidelines (Guidelines) prior to releasing the RFA. HCD did significant work to develop the Guidelines in parallel with the RFA. However, the two development processes had to be mostly sequential, since the Guidelines set the roadmap for HCD's implementation of all aspects of the program, including HCD's selection of the AFM. Indeed, the import of the Guidelines cannot be overstated, as they established the eligibility criteria, scope of work, and legal requirements, rules, and standards for the participants at every level of this tiered funding structure (e.g., AFM, IFMs, applicants, and eligible sponsors). Given the importance of these Guidelines, HCD's sequencing strategy was necessary, but it lengthened the program launch timeline by several months.

HCD did additional research, stakeholder engagement, and best-practices review for FIHPP to ensure a successful program, and in light of the programmatic differences between FIHPP and other HCD programs. While there are a handful of small local programs supporting acquisition and rehabilitation of existing unregulated buildings, there are no programs the size and scale of FIHPP that could serve as models. As such, HCD conducted extensive community outreach with stakeholders from over 40 organizations, including potential project sponsors, potential fund managers, and local governments with acquisition and rehabilitation funding programs.

HCD's intensive and collaborative project resulted in a strong, well-designed, and sustainable program. Meanwhile, many nonprofit organizations benefitted from the additional lead time. Historically, there has been scant funding for the acquisition and rehabilitation of existing, unrestricted properties (and, therefore, little incentive for engagement by nonprofit organizations). HCD's longer development timeframe allowed many nonprofit organizations to build experience and capacity in order to fully participate in the program.

Program Status and Outlook

As described above, HCD has completed its development of necessary program components. The next step is to solicit and select an AFM. The final FIHPP Guidelines were adopted on January 4, 2023 and are available on the FIHPP web page. The RFA for AFM candidates was released on March 8, 2023 with an application due date of May 12, 2023. HCD expects to have a signed grant agreement with the AFM by the summer of 2023. Once assembled, the team of fund managers will then start to execute their scope of work to implement the program and accept applications. This process will likely take approximately six (6) months. HCD anticipates the FIHPP fund managers will be ready to accept applications from potential project sponsors in early 2024.

HCD anticipates that FIHPP funds will be timely deployed to respond to the reemerging upward trajectory of foreclosures. When FIHPP was first proposed during the early months of the COVID-19 pandemic, many stakeholders across the state were concerned that the economic distress caused by the pandemic would lead to a wave of foreclosures along the scale of that seen during the 2007-2008 financial crisis. In fact, foreclosure risk appeared to drop during the first years of the pandemic (see Table 1), possibly due in part to the availability of various income, rent, and mortgage relief programs.

Table 1: Notices of Default for 1-25 Unit Residential Properties in California

Calendar Year	Notices of Default
2018	36,044
2019	32,750
2020	13,127
2021	11,156
2022	25,457

Source: PropertyRadar

However, foreclosure risk increased again in 2022 (see Table 1), though the number of Notices of Default has still not reached pre-pandemic levels. This upward trend may be due to the various COVID-19 relief programs coming to an end, and to the new reality that both tenants and property owners are struggling with costs due to inflation. In fact, the upward trend is likely to continue with additional pressures from high interest rates, which make it less desirable for building owners facing financial distress to refinance, and the real possibility of a potential recession, which would reduce household incomes due to higher rates of unemployment. As such, HCD anticipates demand for FIHPP funds will be high by the time the FIHPP fund managers are ready to accept applications from eligible sponsors.

Conclusion

While the program development process was layered, complex, and somewhat lengthy, HCD is on track to deliver a successful program. As discussed above, HCD is currently finalizing the initial roll-out of the FIHPP program. The foundational program elements, such as the program Guidelines, are already in place. HCD anticipates that all fund managers will be selected in 2023 and will be ready to accept applications from potential project sponsors in early 2024.