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Perspectives

on Affordable Housing & Community Development

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Our Real Estate Practice provides legal services to real estate professionals across the globe.

Article Highlights

Combining LIHTC and NMTC 3
When the Unexpected Becomes Commonplace 5
Searching for the Elusive Lifeline to the Tax Credit Liquidity Crisis 7
News from HUD 9
Reducing Costs in a Tight Market 11
Affordable Housing Debt Markets 12
Affordable Housing Disputes in the Wake of the Credit Crunch 13
San Francisco Eastern Neighborhoods 14
Relief in Sight for HCD Funding Delay 16
Fighting Climate Change with Regional Land Use Planning 17
Summerwood and Sunrise 18

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LIHTC Jumpstart

California Moves Quickly to Award Stimulus Funds

by Gary P. Downs and Irene C. Kuei

On April 30, 2009, the California Tax Credit Allocation Committee ("CTCAC") adopted procedural regulations to award California-controlled stimulus funds that should jumpstart many affordable housing projects. The regulations were drafted to implement the "exchange program" and Tax Credit Assistance Program ("TCAP"), which are direct funding mechanisms created under the American Recovery and Reinvestment Act (the "Act") adopted earlier this year. These programs are designed to provide billions of dollars of relief to low-income housing tax credit ("LIHTC") programs nationwide. While these programs are only temporary, they are likely to be critical to developers with stalled projects.

The Federal Programs

The Act allows states to forfeit their right to receive LIHTC allocations in exchange for cash grants of 85 cents for each dollar of foregone credits, multiplied by 10. States may forfeit up to 100% of their 2009 carryover credits and up to 40% of their 2009 credits. TCAP provides $2.25 billion of HOME funding to be coordinated with the LIHTC program to fill financing gaps caused by the credit market collapse. CTCAC must commit to expend 75% of the TCAP funds by February 2010.

continued on page 2

LIHTC Jumpstart

(continued from page 1)

The California Program

CTCAC has collaborated with industry stakeholders to issue the new regulations setting up a program to award exchange and TCAP funds to projects that have been unable to find LIHTC investors or that have found investors at credit prices too low for project viability. Such funding will be in the form of 0% interest rate loans payable solely from residual cash receipts with a 55-year term and secured by a subordinate deed of trust. The CTCAC regulations provide that projects with a LIHTC reservation (either 4% or 9%) may compete for gap financing and "cash-in-lieu" awards, as applicable, by filing an application that will be scored in 3 categories with a 250 point maximum. The first category has a 50 point maximum, and points are awarded based on the type of project, including "at-risk," rural, family, single room occupancy ("SRO") and homeless assistance projects. The second category rewards "leverage" and awards up to 100 points based on the percentage of a project budget financed by sources other than gap and exchange funds. The third category is worth up to 100 points and is based on average affordability; projects with 40% or less average AMI receive 100 points. Other highlights of the CTCAC regulations are discussed below.

Changes in Sponsor Financials

CTCAC has clarified that updated market information regarding a project sponsor's assets, liabilities or pending litigation may be cause for denying a loan application for exchange or TCAP funds. In addition, when making cash-in-lieu awards, CTCAC will re-underwrite a project in accordance with enumerated underwriting criteria listed in Section 10327(g) of the CTCAC regulations. In projects where CTCAC provides only gap financing, CTCAC may defer to the underwriting standards and conclusions of an equity partner.

Cash-in-Lieu

Projects with 2007 and 2008 LIHTC allocations are eligible for cash-in-lieu awards of up to 85 cents per reserved federal LIHTC dollar, while awards for projects with 2009 allocations are capped at 80 cents per federal LIHTC dollar. CTCAC will provide cash-in-lieu awards up to 60 cents per state LIHTC dollar for projects with 2007 and 2008 allocations and 55 cents per state LIHTC dollar for projects with 2009 allocations. CTCAC also has clarified that bond projects applying for a full cash-in-lieu award will not need a CDLAC application.

Gap Financing

The CTCAC regulations provide that projects having 2007 and 2008 LIHTC allocations may receive gap financing in an amount up to 15 cents per federal LIHTC dollar based on the shortfall between the committed LIHTC equity and the lesser of 85 cents or the credit equity stated in the original LIHTC application. Projects with 2009 allocations may receive up to 12 cents per federal LIHTC dollar, regardless of whether such financing might create equity above the amount stated in a project's initial LIHTC application.

Maximum Award Amounts

Projects with 2009 allocations have an award maximum of $20 million; special needs, homeless assistance and SRO projects are capped at $25 million. All other project awards are capped at $17 million.

Good Faith Efforts

Applicants will need to provide a narrative describing steps taken to obtain equity contributions and describing issues that inhibit investor interest. The narrative must also identify potential investors that have made unacceptable offers and why the project would not be feasible based on the terms of such offers.

Prevailing Wage

If TCAP funding would lead to additional costs due to federal prevailing wage requirements, CTCAC may account for the higher costs by adjusting the award by an amount of up to 15% of the developer's original application budget for site work and structures. It appears that bond projects with reservations in 2009 are only eligible for TCAP funds, which trigger federal prevailing wages.

Per Unit Rehab Costs Requirement

In the "leverage" scoring category, rehabilitation projects are entitled to points only if per unit rehabilitation costs are at least $40,000; however, "at-risk" projects are exempt from this requirement.

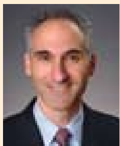
Rental Assistance

In the "affordability" scoring category, projects that receive certain project-based

continued on page 14

From the Chair

James M. Rishwain, Jr.



Pillsbury is proud to present its eighth annual Newsletter on Affordable Housing & Community Development. 2008 was an interesting year for a number of our practice groups. The Firm historically has viewed the affordable housing industry as impervious to most types of economic recession. Despite the industry's unprecedented difficulties, Pillsbury's Affordable Housing & Community Development Group remained solidly busy and our clients were quite active. Although actual deal closings decreased compared to past years, transactions increased. Many of these transactions involved project workouts, tax credit adjuster disputes, lobbying for congressional change, regulatory issues, IRS audits and general company operational concerns. We face a new economy where no assumption is safe. Despite this dire landscape, we look forward to a significant year in the housing industry. We continue to be keenly aware of the affordable housing industry and we seek to anticipate our clients' needs in this evolving area, which will likely face new laws, differing investment plans and serious economic issues.

Combining LIHTC and NMTC

Subsidy Maximization for the Experienced Developer

by Byron A. Rodríguez

Given the popularity of transit villages with green-leaning planners and the limited availability of development sites in dense urban areas, mixed-use affordable housing projects are becoming increasingly popular. These projects range from the "urban surburbia" developments—integrated communities with residential units, grocery and retail stores—to co-located but otherwise unrelated ventures. Regardless of their makeup, many mixed-use projects that benefit from low-income housing tax credits ("LIHTCs") will be located in qualified census tracts, allowing co-located retail or commercial space to be financed with new markets tax credits ("NMTCs"). While combining LIHTC and NMTC sources adds a number of complications beyond even the normal mixed-use concerns, often those may be outweighed by the advantage in cost of funds. We expect the number of combined LIHTC-NMTC projects to increase in the coming years.

Advantages

NMTC projects enjoy a cost of funds advantage over conventional projects

Unlike LIHTCs, NMTCs do not inure to a project owner. Rather, they attach to qualified equity investments ("QEIs") made in a community development entity ("CDE") that has received an allocation of NMTCs from the U.S. Department of the Treasury's Community Development Financial Institutions Fund. The CDE then uses the QEI to make a qualified loan to, or investment in, a qualified active low-income community business ("QALICB"). The NMTCs available to a project (subject to allocation) are 39% of the QEI in the related CDE, and are taken over 7 years. QALICBs must satisfy a number of technical tests; however, most business ventures located in a qualified census track that are not so-called sin businesses or country clubs will qualify. For projects where a QALICB is combining sources of financing, the other sources can be provided in the form of a leverage loan alongside the tax credit purchaser's QEI so that the tax credit purchaser will receive NMTCs not only on the amount of its own QEI, but on the amount of the leverage loan as well.

The financing advantages in an NMTC structure are available because part or all of an investor's expected return on its QEI will be generated by the NMTCs the investor receives for its investment. The resulting advantages to a developer are evidenced by (i) a reduced interest rate on the loan to the QALICB (the developer's single purpose project-owning entity), and (ii) forgiveness of part or all of the QALICB's debt at the end of the 7-year credit period or after the investor has met IRR targets. With these advantages,

continued on page 4

Combining LIHTC and NMTC

(continued from page 3)

incorporating an NMTC project within a housing project development can help support the cost of the entire development to a greater extent than would a conventional retail project.

Mixed-use projects may be favored for entitlement

An easier entitlement process means more money and an earlier payment to the developer. In urban areas with a shortage of development sites, mixed-use projects may be favored by city planners because such projects can address multiple needs at once. In outlying areas, mixed use developments, particularly in municipal and regional transit corridors, are favored by environmentally conscious planners for the resulting decrease in pollution and traffic.

Mixed-use projects are more attractive to tenants

Mixed-use developments with appropriate noise control, tenant safety and privacy provisions can be easier to lease up and may command higher rents (subject to LIHTC restrictions). Grocery stores, dry cleaners, day care, movie rentals and other amenities located on-site provide convenience to tenants and make a development more attractive than its competition. NMTC financing of these amenities lowers total project costs.

Complications

Combining a LIHTC project with other uses creates a number of challenges. Combining a LIHTC project with an NMTC project is even more complicated.

Tax requirements for separate buildings

Tax law generally prevents using both LIHTCs and NMTCs for the same project; however, separate projects located within the same vertical construction may be separately financed using LIHTCs and NMTCs if the projects are in separate condominium units and satisfy other related tax requirements. Statutory subdivision regimes similar to condominiums may also work, regardless of title, depending on how similar they are to standard condominium regimes.

New construction is particularly complicated

Because of their different asset profiles, LIHTC and NMTC portions of a project are likely to have different lenders and investors. This leads to intercreditor concerns that are most compelling during project construction. For example, if the developer of Project A defaults, the lender for Project A will want to be able to foreclose on Project A without needing to deal with Project B participants. Because this may happen during construction, the lenders and investors for Project B must be comfortable with the ability and obligation of the Project A lender to complete and asset manage Project A if the developer runs into problems.

Casualty and condemnation proceeds

Lenders, investors and developers for separate co-located projects need to agree on how to handle a casualty or condemnation affecting the development. Different rules affect the LIHTC and NMTC programs, and lenders and investors will have different preferences regarding reconstruction after a casualty or condemnation. LIHTC investors and developers will be particularly concerned with maintaining the ability to reconstruct during the tax credit compliance period and will want to ensure that condemnation or casualty proceeds of the co-located project will be used for reconstruction, at least to the point of structural integrity. NMTC investors will prefer the flexibility to apply proceeds as they determine to be most advantageous at the time received.

Formulaic underwriting means a smaller pool of lenders and investors

Not all lenders and investors have programs allowing them to easily underwrite mixed-use projects. Especially in the near future, many lenders and investors may prefer readily available vanilla deals. As a result, developers of mixed-use projects may be limiting their investor pool.

Need for broader experience

Retail and office space require different development and property management expertise than residential developments. In mixed-use projects with a commercial component of significant size, lenders and investors will want to see that the developer has relevant experience. Developers may need an additional property manager or may be limited in their choices as to acceptable property managers. Mixed-use projects may also require additional asset management skills within the developer's office.

Tighter closing schedule

Mixed-use lenders and investors will not want to fund until all amounts necessary for construction of an entire development are available. This means that LIHTC and NMTC projects will need to close simultaneously. Because of LIHTC allocation deadlines, this may result in a tighter closing schedule than would otherwise be typical for an NMTC project.

Getting to Closing

For many developments, the benefits of combining LIHTC and NMTC projects will outweigh the challenges. Regular calls between the principal members of the financing teams for the separately financed projects and early identification and discussion of issues like those called out above will help keep closing on track and orderly. Complications can be minimized by assembling a financing team that is familiar with both tax credit programs and with mixed-use development, and, ideally, that has experience closing similar transactions.

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When the Unexpected Becomes Commonplace

Developer Considerations in the Face of Tax Credit Investor Default

by Gary P. Downs and Christian D. Dubois

The affordable housing industry has recently seen an increasing number of projects struggling to stay afloat. Some of the causes are beyond the reasonable control of partnership stakeholders. In some cases, construction cost overruns, overaggressive pro formas, tenant relocation or general weakness in the rental market create an imbalance of sources and uses that renders projects unworkable without outside assistance. However, where project viability is threatened by a tax credit syndicator that fails to make required capital contributions due to tax credit resale issues, careful negotiation may help effect a turnaround. Understanding how to approach such negotiations in this market is crucial as more syndicator funds face equity shortfalls resulting from the scarcity of credit and the thinning market for low-income housing tax credits ("LIHTCs"). This article explores developer considerations that may help mitigate the damages caused by defaults of institutional equity.

The Root of the Problem

Under typical affordable housing limited partnership agreements, the investor limited partner is required to make capital installments in predetermined amounts as the partnership achieves milestones, such as closing of financing, construction completion, lease-up and reaching certain debt coverage ratios. In return for the capital installments, limited partner syndicators receive, among other things, an allocation of LIHTCs, which they typically sell to a LIHTC investor. Historically, the largest LIHTC investors have been Fannie and Freddie, but that demand is gone for now.

The recent liquidity crisis and the suspension of LIHTC purchases by Fannie and Freddie have drastically undercut the LIHTC market, causing uncertainty and reduced pricing for syndicators. As a result, LIHTC syndicators are getting fewer dollars in return for their credit allocations than originally planned. The resulting credit resale gap is compounding syndicator liquidity issues and, in many cases, leaving them without the means to make their required capital installments. When such defaults occur, developers need to take into account a number of considerations to position themselves for a successful workout.

Assessing Project Value

The most pressing concern when an investor defaults is the possibility that the lender will foreclose on the project, so it is important that the developer understand the costs and benefits of foreclosure to the lender. The first step for a developer to assess the lender's position is to perform an analysis of the post-foreclosure value of the project. Only by knowing the potential value of the project to a lender can a developer expect to gauge what a lender is willing to concede to keep the project running. Assessing project value will be complicated by the fact that significant project value is created by tax credits and below-market interest rate assumable financing.

Developers should pay particular attention to factors that may impact project marketability. For example, where soft money funding is still outstanding from cities or other public entities, the soft money lender will need to consent to foreclosure; otherwise, such funds may dry up if the lender moves forward with a plan that jeopardizes the future of the project. In addition, most projects have senior regulatory restrictions that will impact project

continued on page 6

When the Unexpected Becomes Commonplace

(continued from page 5)

value and the lender's ability to market the project to replacement investors. Such reduced marketability may lead to more substantial lender concessions.

Limitations on Investor Liability

When an investor withholds capital contributions, the damages to the partnership and the developer are clearly greater than just the withheld amounts. The resulting strain on sources can undermine relationships with contractors, threaten project viability and reduce or delay project cashflow. Although these factors should be raised when negotiating with investors, developers should take a close look at their partnership agreements to determine whether there is any cap on investor liability.

In many projects, there are specific provisions that limit an investor's liability to the partnership to the amount of the required capital contributions. Although these provisions are not necessarily bulletproof, they may make it more difficult to collect additional damages and they may also reduce the investor's willingness to make concessions.

Relationships Between Investors and Senior Lenders

Where the investor limited partner is an affiliate of the project's senior lender, the developer has the opportunity to leverage this relationship. The developer should request that the limited partner cause the senior lender to forbear to act on all partnership defaults that have resulted from the withheld capital installments and, if necessary, write down debt amounts and/or waive interest on debt payments. Developers should be aware that if a lender has pledged bonds to credit line lenders for the project, the filing of mechanic's liens for delinquent contractor payments may devalue project debt and trigger capital calls to be made by the lender, further depleting the lender's available funds. This may reduce a lender's willingness to make monetary concessions. But it may strengthen the resolve of a lender to work with the developer to prevent the filing of mechanic's liens in the first place.

Of course, where a developer is on the hook for an unlimited construction guarantee, the lender technically can look to the developer for payment; however, it is unlikely that a developer will make voluntary payments under such a guarantee when the project defaults are not the fault of the developer. Lenders will have a particularly difficult time making a straight-faced demand for such payments where the cause of the project defaults is the lender's own affiliate.

Unrelated Lenders

Where the investor limited partner is unrelated to the project's senior lender, the developer should prepare for a more difficult battle. In addition to assessing post-foreclosure value of the project, developers should estimate the likelihood of other lender options and the extent to which these options may affect the lender's willingness to negotiate. For example, a lender may foreclose on a project and cancel bond financing, in which case the lender takes the project without assuming the bond or tax credit regulatory restrictions. Alternatively, the lender may decide that foreclosing on the project while keeping the bonds in place has real value. In either case, the lender may not be willing to seriously negotiate if foreclosure is a better option.

Other Stakeholders

Soft money lenders may be willing to increase contributions to a project where the project is in danger of failing. A developer should be prepared to explain to these entities the importance of the project to the community, the need and planned use for additional funds and the developer's track record of running successful projects. Unfortunately, in the current environment, many cities and public entities are facing significant funding problems of their own and additional soft money may not be an option.

Developers should also prepare to work with contractors regarding the timing of their payments, particularly if the missing investor contribution is triggered by completion of construction. The filing of a notice of completion triggers waiting periods (often 30 to 60 days) for contractors and subcontractors to file mechanic's liens. In some states, including California, agreements in which a contractor forbears to file a mechanic's lien are unenforceable without payment, and a general contractor may be prohibited from waiving subcontractor rights to file mechanic's liens. As discussed above, mechanic's liens can cause serious complications to a project workout. It is important that developers be prepared to work with contractors to determine feasible payment amounts that might dissuade them and their subcontractors from filing.

Time as a Factor

Time is an important factor to achieve a workable solution to an investor default. The ability to quantify the gaps in credit resale and projected sources and uses may take substantial research. Additional time may be needed to resell LIHTCs at the best price available, particularly with the current credit market volatility. Finally, all project stakeholders will need to be negotiated into a standstill so that stakeholders can discuss necessary concessions before project viability and/or marketability are impacted by a rash decision.

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Searching for the Elusive Lifeline to the Tax Credit Liquidity Crisis

The Danger of Over Reliance on Congressional Action

by Gary P. Downs

"Everything comes to him who hustles while he waits."

—Thomas Edison

Most affordable housing supporters believe that the American Recovery and Reinvestment Act of 2009 (the "Act") is a disappointment. On the low-income housing tax credit ("LIHTC") front, the industry has lost almost half of traditional investment. Many popular and efficient affordable housing loan programs are gone or significantly cut back. The affordable housing industry had submitted a number of proposals to help jumpstart the LIHTC market and help permanently sustain subsidy for low-income housing projects. However, Congress decided not to fundamentally change the tax credit rules. Instead the Act was drafted to provide relief in the form of direct project funding through state tax credit agencies. Congress adopted two programs: the "exchange program," which allows a tax credit agency to exchange 40% of its 2009 9% allocation and all of any unused 2007 and 2008 9% allocation, and the Tax Credit Assistance Program ("TCAP"), which provides billions in additional subsidies for state tax credit agencies to award affordable housing projects. These funds must be invested in projects by a certain date and, therefore, do not provide for any type of real permanent subsidy for the industry. In addition, these relief measures may not be sufficient to develop all stalled projects in the current pipeline and, depending on how state agencies decide to allocate the funds, the exchange program and TCAP may not subsidize certain types of projects that were viable in better economic times. Due to the temporary and limited nature of these programs, it remains critical that the industry strive even harder to develop and redevelop tax credit investors. This article discusses a few places to look for new investors.

The LIHTC Liquidity Crisis

Pillsbury first started discussing possible devaluation of the LIHTC in the summer of 2007. By the end of 2007, certain syndicators and direct buyers were shying away from smaller bond deals in rural areas. Fannie and Freddie had exited the market and were selling credits on the secondary market. By the middle of 2008, credit pricing had deteriorated and syndicators and direct credit buyers were cherry-picking deals. It is easiest to understand the LIHTC market collapse through the various bail-out legislation proposals.

Many proposals attempted to restructure the LIHTC as usable by investors projecting severely decreased income and substantial tax loss carry-forwards. These projections meant a dollar-for-dollar credit against tax liability would be unusable if the investor had insufficient future tax liability. The proposals to make the credit refundable, that is, usable without tax liability, with a 5-year carry-back and creditable against AMT would have likely coaxed some historical investors to start investing again.

continued on page 8

Searching for the Elusive Lifeline

(continued from page 7)

Proposals to accelerate the credit may have developed new investors for the market. The gap funding proposals, which became TCAP in the final bill, were obviously a temporary solution to incubate shovel-ready projects. Unfortunately, Congress did not adopt proposals requesting more fundamental change primarily due to cost concerns (the exchange program and TCAP did not add significantly to the cost of the overall legislation). Interestingly, Congress is providing more stimulus for ownership housing despite historic subsidies that already disproportionally favor for-sale housing, even though nearly one-third of all U.S. housing is rental housing.

Developing New Investors Without Congressional Help

In February 2008, the tax credit syndicator panel at Pillsbury's Roundtable Conference said the solution was to develop new investors, but that it would take time. Certainly the LIHTC program adds additional complications to traditional real estate investment. With some minor restructuring, however, true yields (including cash flow and back end distributions) can hit 20% and produce sufficient equity to induce development, even with current purchase and building costs, which costs in almost every market are currently decreasing. Unfortunately, development of new investors has been elusive due to the deer-in-the-headlights reaction to the dysfunctional financial markets. But it can and should still occur. Many industries are unaffected by subprime mortgage failures and current trends in decreased consumer spending. These industries expect future tax liability and can benefit from LIHTC investment. The entertainment industry is a good example. Current and former talent at syndication shops should be busy working on developing these new investors.

The High Net Worth Real Estate Professional Contact

Retail LIHTC sales are unlikely to develop legs without tax law change. Investors currently face an annual LIHTC limit of approximately $10,000 unless they are actively working in real estate. Although a few proposals suggested changes to these rules, the Congressional lobbying effort fell flat. As a result, the more likely target is high net worth real estate developers. A number of our clients are attempting to develop these relationships in an effort to set up a private fund. One point to bear in mind is that without a syndicator, credit-enhancer or multi-investor pool, investment documents can look very

Northwood Place

Pillsbury represents Allied Pacific Development, the developer affiliate of Pacific Housing Advisors, in a partnership with Ketchum Community Development Corporation to build a 32-unit affordable housing project in Ketchum, Idaho, a small town near the Sun Valley ski resort. The project, known as Northwood Place, was recently awarded a nearly $9 million allocation of federal low-income housing tax credits to fund the new construction. Allied has worked closely with community officials in Ketchum to ensure that the development blends into the existing architecture of Ketchum and has an energy efficient design. In addition to tax credit equity, Allied will be taking advantage of the Rural Development Section 538 loan guarantee program. The project is expected to be ready for occupancy in the summer of 2010.

different from typical deals. A developer may be able to whittle down guarantees to just a tax credit guarantee at the upper tier, possibly meaning that the developer's risk of draw on the guarantee decreases due to project diversification. For instance, downward adjusters on one project could cancel out upward adjusters on another.

Self-Funded Equity

One replacement strategy involves the developer self-funding equity by reinvesting its cash developer fee into the transaction. In most situations, the cash developer fee is insufficient to fully fund the needed equity. In these cases, the developer has asked the project seller to carry back debt in lieu of the cash purchase price to make up the difference. This option is practically only available for smaller deals and only the largest development companies can use it on more than a couple of transactions. Because the structure guts the cash developer fee, the developer is left short of cash to run its operating company. This structure also raises phantom income issues because the developer will need to pay tax on the developer fee but will probably need to fund the entire amount into the equity side of the transaction. However, this will remain a viable means to fund developments that are not currently competitive for exchange and TCAP funds under state programs or once those program funds have run out.

New investors, real estate professionals and equity self-funding can all help projects that lack funding. These solutions have their complications, requiring in most cases outside consultants to help execute. Lively "hustle" is an important ingredient in reestablishing historical investment levels. Pillsbury is available to advise on these and any other affordable housing matters.

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News from HUD

by Irene C. Kuei and Noa L. Clark

New Secretary of Housing and Urban Development

In an effort to end the mortgage crisis and get the economy back on track, President Obama has emphasized the role of the Department of Housing and Urban Development ("HUD") in expanding access to affordable housing. The President has stressed the importance of approaching the challenge with new energy, new ideas and efficient leadership and, to this end, nominated Shaun Donovan to be Secretary of HUD. Donovan sailed smoothly through the confirmation process and was confirmed by the Senate on January 22, 2009. Industry leaders and senators praise Donovan for his experience in spearheading the expansion of affordable housing, and many changes are expected at HUD under Donovan's leadership. Donovan has pledged to work with Congress to address budgetary issues associated with the renewal of the expiring Section 8 rental subsidies, to reform the management of HUD and to make efforts to "green" HUD's portfolio by focusing on the development of communities that are livable, walkable and sustainable. President Obama's emphasis on HUD's role in getting the economy back on track along with Donovan's innovative ideas and track record appear to signal a more sweeping role for HUD in overseeing the affordable housing industry.

Spurred Interest in Section 221(d)(4) and 223(f) Programs

In response to the lack of financing options in the market, HUD is taking important steps to spur the use of its programs, which were in the past largely ignored by developers because of the abundance of liquidity in the market

continued on page 10

News from HUD

(continued from page 9)

coupled with HUD's often cumbersome procedures. For example, to facilitate the use of HUD mortgage insurance programs, HUD issued new procedures so that properties with master leasing structures may now be eligible for HUD-insured mortgage loans upon approval by HUD headquarters. HUD also eliminated the need for subsidy layering reviews of FHA-financed projects that have already gone through the subsidy layering review with the state tax credit agencies. HUD's efforts have not gone unnoticed. Developers are starting to revisit the long forgotten Section 221(d)(4) and 223(f) programs as HUD moves forward with easing certain requirements under these programs.

Reduction of Cash Escrow Requirements Under Section 221(d)(4)

HUD's Section 221(d)(4) program insures mortgage loans, offering insurance to lenders against loss on mortgage defaults, to facilitate new construction or substantial rehabilitation of multifamily housing for moderate-income families, the elderly and the handicapped. Under Section 221(d)(4), for-profit sponsors may receive a maximum insured mortgage of 90% of the project's estimated replacement cost. In the past, the Section 221(d)(4) program was not an option for many low-income housing tax credit ("LIHTC") transactions because of its equity funding requirement. Previously, if a project applying for Section 221(d)(4) HUD mortgage insurance would receive LIHTC proceeds or equity, the program required the funding of 100% of the LIHTC proceeds or equity prior to closing, which imposed a substantial burden on the mortgagor. However, effective July 22, 2008, HUD revised its policy to increase the program's flexibility. Now, the mortgagor is no longer required to deposit 100% of the LIHTC proceeds or equity prior to closing. Rather, HUD regulations recommend that the initial installment of LIHTC proceeds or equity be an amount equal to at least 20% of the total LIHTC proceeds or equity. If less than 20% is proposed, review and approval by HUD headquarters is required.

Temporary Waiver of 3-Year Rule Under Section 223(f)

HUD's Section 223(f) program insures mortgage loans to facilitate the purchase or refinancing of existing multifamily rental housing. Previously, to be eligible under this program, the project must have been completed or substantially rehabilitated at least 3 years prior to the date of the application for this mortgage insurance. HUD, however, recognizes the need to assist the developers in securing permanent long term financing or refinancing options to take benefit of the low interest rates the current market has to offer despite the credit crunch. Effective February 6, 2009, HUD revised its policy to grant temporary authority to the Multifamily Hub Directors to waive this 3-year rule. Under the new rule, in addition to certain other conditions, to be eligible, the projects must have received a certificate of occupancy no later than July 31, 2008. This temporary waiver is set to expire approximately 6 months from publication; however, if the program is effective, HUD may elect to extend the program.

We expect that the revised and streamlined policies will make these programs attractive options for project sponsors looking to secure financing for their projects.

Northridge Cooperative Homes

ICON Builders is over 85% complete with a substantial rehabilitation of the Northridge Cooperative Homes in the Bayview Hunters Point neighborhood of San Francisco. Pillsbury represented ICON Builders, as general contractor, in negotiations with the San Francisco Redevelopment Agency, HUD and the project's Tenant Owner Association in negotiating workable construction requirements. The 300-unit occupied property was in dire need of renovations, which include the exterior siding, windows, roofs and completely new interiors. The cost of the renovations is $25 million.

Revised Section 8 Renewal Policy

In an effort to encourage owners to preserve affordable housing, HUD increased the allowable distributions to for-profit owners of properties with Section 8 assistance. Effective April 13, 2009, HUD's revisions to the Section 8 Renewal Policy Guide allow for-profit owners to take increased distributions when renewing or extending contracts on a long term basis under "Option Two" MAHRA renewals. Significantly, for-profit owners of 100% Section 8 assisted properties may keep all surplus cash if the property is "maintained in good condition," measured by an REAC score of 60 or greater.

For partially assisted properties that are not Section 236, 221(d)(3) or 515, for-profit owners may keep all surplus cash if the property received an REAC score of 60 or greater and the Section 8 rents do not exceed the non-Section 8 rents. For partially assisted Section 221(d)(3), 236 and 515 properties, for-profit owners are eligible for increased distributions on the Section 8 units, calculated by adding the increase to the current limited distributions on unassisted units if the property received a 60 or greater REAC score. If, however, an owner agreed to waive payment of distributions, as is the case with nearly all flexible subsidy contracts, the increased distributions will be reduced to repay HUD the pledged amount.

As always, we are happy to help our clients understand and navigate HUD's policies and procedures and we will continue to monitor HUD developments throughout 2009.

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Reducing Costs in a Tight Market

Direct Sourcing Chinese Materials

by Byron A. Rodríguez

As developers look to reduce project costs in a troubling market, some are finding meaningful cost savings by sourcing materials directly from overseas manufacturers. Construction or rehabilitation of a large apartment complex involves a substantial amount of materials, including finished cabinetry, countertops and fixtures. These materials are generally procured in the United States at prevailing costs, which can include a number of layers of overhead and profit. By going directly to factory owners in China (or their U.S. brokers), developers have been able to cut out some of these layers and push down their costs. In addition to reducing costs, direct sourcing allows an upgrade to finishes like custom fabricated granite countertops that are less expensive than lower quality domestic products.

Direct sourcing materials from overseas involves a number of special considerations. Orders must be placed with some lead time, and factories will often require at least partial payments up front. This can create problems for lenders, who generally will only disburse funds for materials stored on-site. In some cases, with lender cooperation, this can be solved through the posting of a letter of credit or a guaranty by the owners of the factory, depending on their location and creditworthiness. Another potential issue with direct sourcing is that once products are delivered, factory warranties may be difficult to enforce unless backstopped by broker or principal guarantees. Also, building codes generally require that certain components, like light fixtures, be certified by Underwriter Laboratories (that ubiquitous little "UL" stamp on electronics), and not all factories will be set up for such certifications. As a result, developers may decide that direct sourcing makes sense for some materials, but not others.

Developers, lenders and contractors not working through a broker may want to visit a factory site to assure themselves of quality control and ability to deliver on time. Developers will benefit from open communication with factory owners as to project needs. For example, if a developer is indifferent as to granite color, or even as to consistency of color throughout an order, that can help a factory owner push down its own materials cost and result in savings to the project.

Direct sourcing may create some initial anxiety, but the potential savings, particularly over a number of deals, can be substantial. Finding a reliable overseas partner seems challenging at first, but working through referrals and a diligence trip can help alleviate these concerns. For projects that are at the margin, the resulting savings can make an important difference in project viability.

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Affordable Housing Debt Markets

Down, but Not Out

by Gary P. Downs and Bradley D. Scheick

Increasing capital costs resulting from the subprime collapse and credit crunch have taken a significant toll on the affordable housing industry. Low-income housing tax credit prices have fallen, making equity scarce and investing standards tighter. Many lenders have exited the market altogether leaving developers wondering where to find debt and if tax-exempt bond deals are workable at all. Although it is true that many lenders are lying in wait, particularly for market demand to return for tax-exempt bonds, debt remains available for projects with strong pro formas, experienced, well-capitalized developers and the right structure.

One area of continued lending activity is private placement bond financing. According to Gabriel Speyer, Vice President of Bank of America's Community Development Bank, private placements are currently "viewed as more stable [than public placements] because [the lenders] act as their own bond buyer and fewer stakeholders participate in the deal."

Although some banks remain active in private placements, the number of banks operating private placement programs has dropped significantly over the past year. Banks remaining in the market have raised rates and increased selectivity in the deals they undertake. As Speyer notes, spreads on such privately placed bonds have widened and underwriting standards have tightened. Many providers now require more detailed information regarding proposed investors and insist on at least 10% of total equity at bond closing.

Similarly, the market for publicly placed fixed rate bonds has been battered by rate increases and a shortage of willing buyers. As a result, the most viable option for those seeking tax-exempt bond financing is credit-enhanced variable rate public placements. CitiBank's Steven Fayne says that, unfortunately, "to get these deals to pencil, borrowers must do a swap to a fixed rate [which yields a lower all-in interest rate than private placements or fixed rate bonds] and the market of creditworthy swap providers is down to one or two [providers]." Furthermore, with Fannie Mae largely on the sidelines of the bond markets, Freddie Mac is now the primary source of credit enhancement for these types of public placements. According to Fayne, "Freddie's pricing has increased to 100 basis points annually for liquidity—up from 25 basis points—plus a one point fee."

Fannie Mae has not been completely inactive. Recently Fannie has been lending to 9% deals where loan-to-value does not exceed 90% and debt service coverage exceeds 1.15x. However, rapidly changing spreads and 10-year Treasury note volatility are resulting in short-lived quotes. In addition, Fannie, like most lenders, is significantly strengthening its underwriting criteria. And, for the time being, it is staying out of 4% deals while fixed-rate bond buyers remain on the sidelines.

We are also seeing an increasing number of projects turning to FHA HUD-insured loans, in particular Section 221(d)(4) and 223(f) loans. These programs are discussed in the "News from HUD" article in this Newsletter.

Overall, the picture for the affordable housing debt market appears weakened but relatively stable. While some private lenders and public agencies remain active, their pricing, selectivity and underwriting requirements have increased. Developers will continue to struggle structuring viable deals, especially given the state of the equity markets. The struggles, and the contracted state of the debt markets, will likely continue until the equity markets improve. As Speyer notes, "equity drives deals, not debt," and, therefore, "[f]or a significant uptick in bond activity, the market for low-income housing tax credits will need to rebound."

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Litigation Focus

Affordable Housing Disputes in the Wake of the Credit Crunch

by Marc H. Axelbaum

As the credit markets have dried up in the wake of the global financial crisis, partners in affordable housing transactions have found themselves increasingly at odds. In the past year, certain investor limited partners have become more willing to delay or refuse to pay capital contributions that in previous years would have been timely paid in full. In a parallel trend, co-general partners have failed with increasing frequency to live up to their obligations to fund a project, which can result in poor maintenance that jeopardizes a development's tax-advantaged status.

Investors will sometimes invoke the complex tax credit "adjuster" provisions of the limited partnership agreement as a pretext for reducing or even completely withholding capital contributions. In the past, parties could often work out their differences with the help of experienced accountants in the affordable housing industry. Recently, however, limited partners have become less concerned about pushing these disputes toward litigation. When this happens, Pillsbury's litigators with extensive background in the affordable housing industry stand ready to enforce the parties' contractual obligations.

Pillsbury successfully litigates partnership disputes involving tax credit adjusters, which are standard provisions in partnership agreements that require a true-up with investors for the timing and amount of tax credit delivery and depreciation deductions. The resolution of adjuster disputes is a two-step process. First, we review the adjuster provisions of the partnership agreement. Despite appearing absolute, a single agreement often contains multiple qualified adjusters or adjusters that mitigate each other's impact. Second, a forensic accounting expert must derive the true-up number specified by a particular adjuster by evaluating the competing cash flow and tax credit values over the anticipated life of the project. Pillsbury's experience has allowed us to develop creative but sound arguments interpreting limited partnership agreements. We enjoy strong professional relationships with several firms having expertise in the economics of affordable housing development, a critical aspect of credibility when presenting opinion testimony in adjuster dispute cases.

When adjuster disputes involve a delayed or disputed capital obligation of the limited partner, which increasingly occurs in today's economy, the investor has an opportunity to reap undue benefits. Under the cash flow and time/value financial models that are inherent in the financial structure of affordable housing projects, a limited partner investor can enjoy a larger rate of return on its capital investment simply by delaying a required capital installment payment. Financial equity demands an increase in capital installment payment amounts if the project investors make a late installment payment. Whether or not a project partnership agreement expressly allows for upward capital installment payment adjustments, Pillsbury has had success in enforcing such adjustments against limited partner investors.

Another emerging area of our affordable housing litigation practice relates to the failure of a co-general partner to fund a project, making development and maintenance difficult or even impossible. At the beginning of a project, the general partners may see eye-to-eye about their obligations under the operating agreement. But as a project's cash flow begins to ebb, as has happened with unfortunate frequency in recent times, the general partners' respective views of necessary development costs, maintenance and project oversight may diverge substantially. When that occurs, one general partner may find itself chasing the other for substantial, and substantially overdue, capital contributions. Of course, underfunding can deplete operating reserves, jeopardize a project's tax-advantaged status, trigger repayment obligations under loan agreements and spark investors to attempt to remove both general partners regardless of which one has caused the default.

In situations such as these, Pillsbury's litigators have experience protecting our clients' interests on all fronts, from drafting a persuasive demand letter to pursuing or defending full-blown litigation in front of an arbitrator or judge. Pillsbury's litigators also team with the firm's affordable housing transactional lawyers to help clients position themselves in negotiations with an eye toward avoiding, but being prepared for, litigation down the road. While careful drafting and negotiation before a transaction begins will help clients avoid many potential disagreements, even well-drafted partnership agreements do not always prevent disputes. Pillsbury has the litigation experience and expertise to assist our clients in resolving the myriad issues that arise after the deal is done, particularly in today's uncertain financial markets.

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LIHTC Jumpstart

(continued from page 2)

or operating subsidies are deemed to be at an average 40% AMI affordability, regardless of actual rental restrictions, entitling such projects to the full 100 points in the category. Such subsidies include HUD Project Rental Assistance Contracts and Section 8 assistance, funding under the Mental Health Services Act, McKinney Act subsidies and locally funded operating subsidies approved by CTCAC.

Debt Service Coverage Requirements

Each project must demonstrate that the debt service coverage ratio in the first year will be at least 1.15 to 1.

Award Timing

Although at the time of publication of this Newsletter award competition dates had not yet been set, we expect CTCAC will hold two rounds this year. The first will likely require applications in June with an award relatively shortly thereafter. The second will likely be at the end of 2009, and will allow awardees of the 9% credit round in 2009 to compete for these funds. The few types of projects that are excluded from competition may apply on an over-the-counter basis.

The Road to Recovery

Although a long term solution is needed to help address the current affordable housing production crisis, the CTCAC regulations are important temporary relief. Pillsbury is available to navigate its clients through the awards application process to get stalled projects moving again.

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San Francisco Eastern Neighborhoods

by J. Gregg Miller, Jr. and Mervyn E. Degaños

Background

After more than a decade of planning and negotiations, San Francisco's planners and politicians have finally approved the rezoning of the City's so-called Eastern Neighborhoods. The Eastern Neighborhoods Plan (the "Plan") legislation took effect on January 19, 2009, and impacts the Mission, Showplace Square/Potrero Hill, Central Waterfront, and East South of Market neighborhoods. The rezoning encompasses most of the City's remaining industrial lands (other than the Bayview Hunters Point areas) and covers approximately 2,200 acres. A quick look at the rezoning map hints at the complexity of a process that involved diverse neighborhoods and the varied interests of residents and other stakeholders. For example, the rezoned area is not contiguous due to the fact that certain neighborhoods successfully lobbied to be removed from the Plan.

One of the main objectives of the Plan is to stimulate affordable housing development in certain formerly industrial zoning districts, which have been re-zoned as "Urban Mixed Use" (aka "UMU") districts. The increased affordability requirements of the UMU districts, when combined with other elements of the Plan designed to reduce development costs, may create fertile ground for affordable housing development.

UMU Zoning Districts Promote the Development of Affordable Housing

The UMU controls require residential developers to meet dramatically higher

inclusionary requirements for affordable units compared to requirements elsewhere in the City. Current citywide inclusionary requirements mandate that (i) 15% of the dwelling units in any development of 5 or more dwelling units be affordable to persons making at most 80% of AMI (calculated using City and County of San Francisco data), (ii) the developers provide off-site affordable units equal to 20% of the total number of units or (iii) the developers pay an in-lieu fee calculated on 20% of the total number of units. In comparison, developers in the UMU must provide between 18-22% on-site affordable units, 23-27% off-site affordable units, or an in-lieu fee calculated on 23-27%, depending on the amount of height increase provided under the new zoning controls.

Alternatively, developers may satisfy the affordability requirements by dedicating a portion of their land to the City, thereby allowing the City to construct a 100% affordable project on the dedicated land. If developers of large lots or assemblages in the UMU determine that market-rate development is feasible under this option, the City may find itself owning several lots on which it may develop 100% affordable projects. Most likely, the City would effect the development of such parcels through an RFP process with affordable housing developers under which the City would ground lease the dedicated parcels to the affordable developer selected. Thus, the UMU zoning controls may create new affordable housing sites through the land dedication alternative.

The increased affordability requirements will likely prevent profitable market-rate development, particularly for developers who purchased land in the last five years. One result may be lower land prices, which, when combined with the tax incentives available to affordable housing developers, may make affordable housing developments especially economical in the UMU zoning districts. The Plan encourages affordable housing development in the UMU through reduced development fees for such projects. In most plan areas, residential development that results in net-new residential square footage is subject to per-square-foot fees that currently range from $8-16, depending on the height increase provided under the new controls. However, developers of net-new residential development in the UMU and developers of 100% affordable projects anywhere in the Plan area must pay only the lowest fee ($8 per square foot). In addition, under the UMU controls, a 30-year rental project that meets certain criteria is entitled to a lower affordability requirement (3% lower than the for-sale requirement if the affordability requirement for the rental project is met on-site, off-site or through the in-lieu fee and 5% lower if the requirement is met through land dedication) and a $1 reduction in the $8 per-square-foot development fee mentioned above. Developers with experience doing “80/20” projects may be able to satisfy the reduced affordability exactions and may find it economically feasible to build rental projects in the UMU in light of the reduced affordability requirements and development fee.

The increased affordability requirements of the UMU districts, when combined with other elements of the Plan designed to reduce development costs, may create fertile ground for affordable housing development.

Certain Aspects of the Plan May Reduce Development Costs

In addition to specific UMU zoning district controls that encourage affordable housing development, a number of the Plan’s general provisions may reduce development costs for all types of residential development, further promoting the development of affordable housing. For example, residential development is now permitted in much of the Eastern Neighborhoods and does not require discretionary review, although large projects (defined as projects that will result in a building taller than 75 feet, involve the construction of more than 25,000 square feet, or have more than 200 feet of contiguous street frontage on a public right-of-way) are subject to individual design review by the San Francisco Planning Commission. Density limits, described in terms of floor-to-area ratios, are mostly removed, subject to requirements for a certain mix of bedrooms per unit (30% of the units must be at least 3BDR or 40% must be at least 2BDR) and open space requirements. Residential developments are no longer required to provide off-street parking, potentially creating significant cost savings for developers. For the most part, residential development does not have to be accompanied by other uses, such as ground floor retail. In some areas, the Plan meaningfully increases height limits. In addition, small project developers having projects that conform to Plan requirements, such as height and bulk requirements, may be able to rely on the Plan’s programmatic environmental impact report (“EIR”) to satisfy California Environmental Quality Act requirements, thereby potentially eliminating the need for a project-specific EIR. These aspects of the Plan may create substantial cost savings and reduce potential development delays.

Conclusion

Affordable housing developers should look at the UMU zoned areas of the Plan as potentially fertile ground for projects. Pillsbury has attorneys with extensive experience in land use and affordable housing transactions well positioned, especially in San Francisco, to help our clients contemplating residential or affordable housing projects in light of the Plan.

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Relief in Sight for HCD Funding Delay

by Irene C. Kuei

As California has wrestled with a budget shortfall of $40 billion, the California Department of Housing and Community Development ("HCD") informed developers on December 17, 2008, that the Pooled Money Investment Board ("PMIB") unanimously voted to suspend the financing of more than 1,985 infrastructure projects throughout California. A wide range of projects throughout California totaling $16.2 billion were affected. The most troubling aspect of PMIB's action for affordable housing, however, was that it prevented HCD from providing permanent financing to developers through its Multifamily Housing Program ("MHP"), Infill Infrastructure Grant Program ("IIG") and Transit-Oriented Development Housing Program ("TOD").

Over the last few months, Pillsbury and many affordable housing developers have worked together to ensure that PMIB and HCD understand the importance of affordable housing in California. During PMIB's February meeting, Pillsbury and many affordable housing advocates spoke in front of State Treasurer Bill Lockyer, State Controller John Chiang and Director of Finance Michael Genest, urging immediate action to fund the various HCD programs. The voice of the affordable housing industry was heard and answered. PMIB announced during its March meeting the potential sale of $4 billion in state general obligation tax-exempt bonds in late March. As of March 24, 2009, State Treasurer Lockyer had sold $6.54 billion in state general obligation tax-exempt bonds, surpassing PMIB's original goal.

Due to the success of the State Treasurer's tax-exempt bond sale, on April 3, 2009, the Department of Finance authorized HCD to spend $164.5 million on projects with the greatest need for cash. HCD has identified 162 projects that will be funded from the $164.5 million. A complete list of these projects can be found at http://www.dof.ca.gov/capital_outlay/funding_released/.

Relief may be in sight for projects still awaiting funding. The Treasurer's Office scheduled an additional tax-exempt bond sale for late April. If the bond sale goes well, HCD expects to fund more projects in the coming weeks.

How Much Proposition 1C Money Remains for MHP, IIG and TOD?

Millions of Proposition 1C money will be available for MHP, IIG and TOD once the suspension ends. Based on data published by HCD as of June 30, 2008, we have the following data regarding Proposition 1C allocations: (i) of the $345,000,000 allocated to MHP, $195,240,057 has been committed and $149,759,943 remains available to developers; (ii) of the $790,000,000 allocated to IIG, $340,000,000 has been committed and $450,000,000 remains available to developers; and (iii) of the $300,000,000 allocated to TOD, $145,000,000 has been committed and $155,000,000 remains available to developers.

Programs Favored by HCD

Many of those who talked with HCD in 2008 noticed a big push for developers to utilize IIG and TOD and less emphasis on MHP. Within the MHP program, developers have also noticed a strong preference for new construction projects rather than acquisition and rehabilitation projects. We expect this trend to continue once the suspension ends.

HCD in the Near Future

The HCD funding issues that developers have recently encountered are symptomatic of the funding difficulties faced by the affordable housing industry as a whole as California and the nation wrestle with what many are calling the worst economic downturn since the Great Depression. It is vital that members of the affordable housing industry continue to be active to ensure that the critical role of the affordable housing industry in the economic recovery is not ignored or hampered and that vital funding programs such as those under HCD do not fall victim to shortsighted cuts.

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Fighting Climate Change with Regional Land Use Planning

by Todd W. Smith and Michael A. Peers

On September 30, 2008, California Governor Arnold Schwarzenegger signed into law Senate Bill 375 ("SB 375"), which, according to the Governor's signing statement, "constitutes the most sweeping revision of land use policies since Governor Ronald Reagan signed the California Environmental Quality Act ("CEQA") nearly four decades ago." SB 375 melds regional transportation and local land use planning in an effort to curb global warming by reducing greenhouse gas ("GHG") emissions targets for motor vehicle use. Of particular interest to affordable housing developers, SB 375 creates a new regional planning mechanism—referred to as the sustainable communities strategy ("SCS")—that promotes high density, transit-oriented development, and creates incentives for specifically defined, high-density development projects.

SB 375 creates an exemption from CEQA for "transit priority projects" that are consistent with the SCS and a streamlined CEQA review for various other transit priority projects. A "transit priority project" is an infill development project that contains at least 50% residential use based on square footage, a minimum density of at least 20 dwelling units per acre, and is located within one-half mile of a major transit stop or "high quality transit corridor." A transit priority project developer must also provide at least 20% housing for sale to moderate-income families, 10% rental housing for low-income families, or 5% rental housing for very low-income families. In-lieu fees sufficient to result in the development of an equivalent number of units stated above or providing 5 acres of open space per 1,000 project residents will also qualify the transit priority project for the CEQA exemption.

While SB 375 allows the CEQA exemption or a streamlined CEQA review for transit priority projects consistent with the SCS, it will likely take years before an SCS is adopted. Additionally, the extent of increased transit priority project efficiency due to the CEQA exemption or streamlined review is uncertain. The threshold environmental review is more intensive than is normally the case for CEQA exemptions. Nevertheless, public agencies and individual stakeholders—in particular developers and landowners—should plan to participate in drafting the SCS to help shape the direction of this important regional planning process and ensure that affordable housing will be at the forefront of community development.

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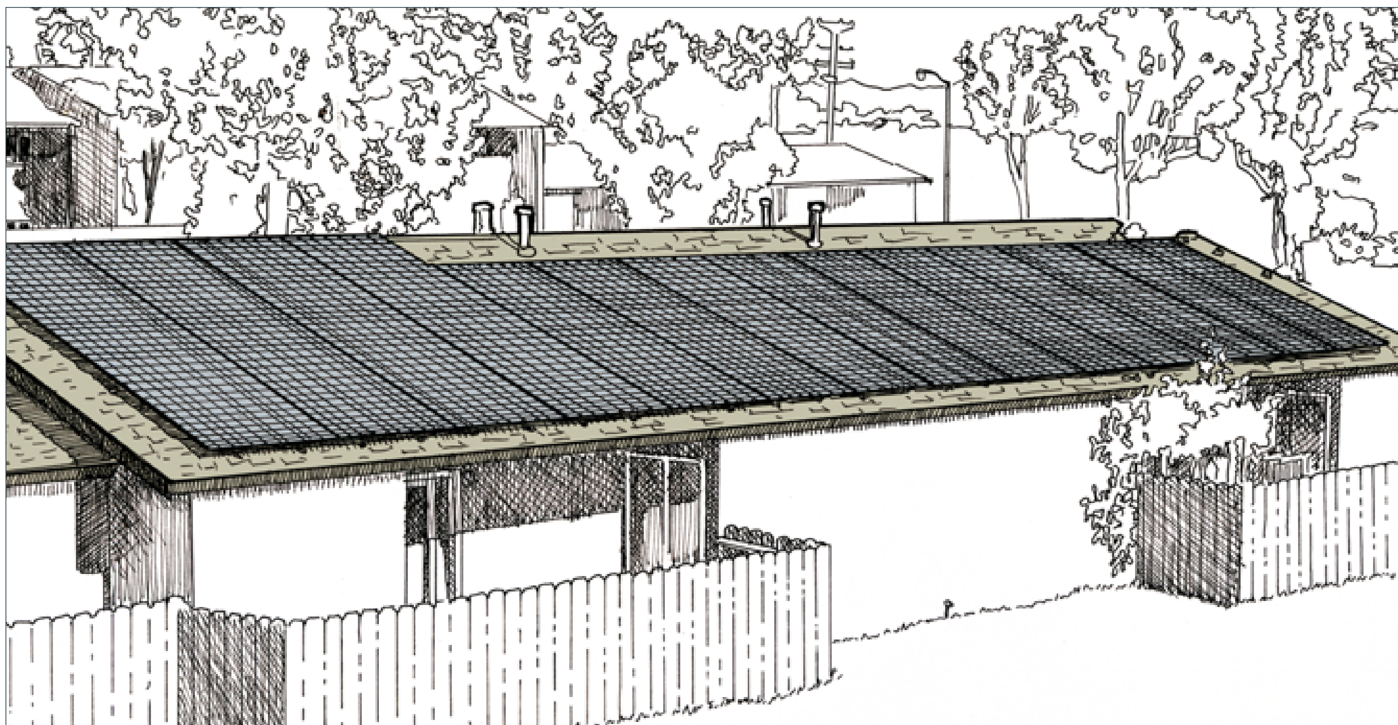

Summerwood and Sunrise

Affordability Meets Sustainability in Riverside, California

by Christian D. Dubois

Highland Properties Development is helping prove that affordable housing can also be green housing. Two Highland multifamily housing projects in Riverside County, California— Summerwood Apartments and Sunrise Apartments—now have solar panels on their roofs and are reaping the benefits of more than just the cheap electricity being generated. With Pillsbury's assistance, the Summerwood and Sunrise projects are taking advantage of both low-income housing tax credits and Section 48 energy investment tax credits. Pillsbury helped set up a structure in which the energy investment credits are claimed by an affiliate of the project partnership that leases the panels from the project partnership under a master lease agreement and, in turn, sells electricity to the partnership under a power purchase agreement. This structure looks to become increasingly popular with some of the recent legislative changes that are discussed in this article.

Because the projects were financed with tax-exempt bonds, the partnership needed to take certain measures to avoid an approximately 50% tax credit hit that is mandated under Section 48(a)(4) of the Internal Revenue Code for energy investment tax credit basis generated by bond-financed property. Pillsbury and Highland worked with the projects' bond issuer and lender to amend bond documentation by clarifying that the panels were not collateral for the bonds and that the projects did not use bond proceeds to acquire, install or operate the panels. As discussed below, this additional work will not be necessary for future solar projects.

Pillsbury has assisted several clients to establish similar structures that take advantage of the energy investment tax credit program. Until recently, many affordable housing developers were apprehensive about whether such structures would pencil out, particularly because of the short term sunset provision of the 30% energy credit (which at expiration would return to a 10% credit). Fortunately, the recent passage of the Emergency Economic Stabilization Act of 2008 extends the 30% energy investment tax credit through 2016.

Further help came with the passage of the American Recovery and Reinvestment Act of 2009 (the "Act"), which eliminates the need for tracing investment credit basis away from tax-exempt bond financing by removing the Section 48(a)(4) bond "taint." The Act also allows taxpayers to elect to receive a grant in lieu of the investment credit for 30% of the solar equipment basis. The grant option may be useful in expanding the pool of investors for these solar structures. In light of these legislative changes, Pillsbury is optimistic that more affordable housing developers will consider adding sustainable energy systems in the near future.

Solar Credit Investor

Power Purchase Payments and Energy Credits

Tax Credit Partnership

Energy LLC

Lease Payments and Power

Solar Energy Credits in a LIHTC project

It is important that developers interested in going green talk with their lenders and investors about the potential solar structure before signing loan documentation and partnership agreements. In cases where lender or investor consent might be required to effectuate such a structure, developers should consider adding provisions to loan and partnership documentation that require the lender or investor to review and negotiate in good faith the terms of any required documentation if and when the developer proposes the structure. Such provisions can provide developers a degree of comfort that their later efforts to go green will not face unnecessary hindrance or delay.

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COMING IN JUNE...

An Affordable Housing Webinar

California's Gap Financing and Cash-in-Lieu Award Programs

Pillsbury will team with industry experts in an online discussion of California's implementation of the federal exchange program and TCAP that were created under the American Recovery and Reinvestment Act of 2009. Gary Downs will serve as moderator of this free-of-charge webinar. Invitations with further details to follow.

Houston | London | Los Angeles | New York | Northern Virginia | Orange County | Sacramento | San Diego
San Diego North County | San Francisco | Shanghai | Silicon Valley | Tokyo | Washington, DC

Westbrook Plaza Health Center

Pillsbury represented South of Market Health Center in financing the nonprofit's Westbrook Plaza Health Center, a mixed-use project near downtown San Francisco that was developed jointly with Mercy Housing. The project, which involved demolition of an existing structure in an historic district, features an underground garage, a courtyard and two buildings with 20,000 square feet of health clinic space and 48 units of affordable rental housing. Project funds were derived from a number of sources including equity generated from New Markets Tax Credits and federal low-income housing tax credits, and a series of grants and loans from the San Francisco Redevelopment Agency. The New Markets Tax Credits were available through an allocation from NCB Capital Impact. Most of San Francisco's senior elected officials turned out for the project's ribbon-cutting ceremony.

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