BAHFA PROGRAM DESCRIPTION

INNOVATION PROGRAM

Equity Objectives	The Innovation Program (the "Program") will invest in projects that support achievement of the Equity Framework's Production, Preservation, and Cross-Cutting Objectives.[1] In particular, by funding projects that are faster to market and lower cost, as well as piloting new financing and delivery approaches, the Innovation Program will help meet the Equity Framework's objectives of creating more affordable housing, including for extremely low income (ELI) households. Further, by providing funding to projects that will not apply for low income housing tax credits (LIHTCs),[2] the Program will allow for more geographic flexibility to invest in communities identified in the Equity Framework as priorities, such as those in which there has been historical disinvestment.
Additional Objectives	Additional objectives of the Program are to: • **Support BAHFA's Legislated Production and Preservation Goals.** A combined minimum 67% of Regional Housing Revenue[3] ("RHR") raised by BAHFA is required to be distributed, in the form of a grant, loan or other financing tool, for either the production of rental housing that is restricted to be affordable to lower income households up to 80% AMI for at least 55 years ("Production") or for the preservation of deed-restricted housing, affordable to households up to 120% AMI for 55 years ("Preservation"). An additional 18% may be used for Production, Preservation, or Protections. A majority of projects receiving funding from this Program are anticipated to be faster, lower-cost new construction projects that contribute to meeting BAHFA's Production goal (to which a minimum 52% of RHR must be provided); however,

[1] The Production, Preservation, Protection Objectives are stated in the Multi-Family Rental Production Program, Anti-Displacement and Preservation Program, and Tenant Protections and Homelessness Prevention Program descriptions, respectively, along with the Cross-Cutting Objectives. All objectives are also included in the Equity Framework.
[2] Projects located in census tracts designated as "high opportunity" currently receive a scoring advantage when applying for tax credits. In practice, this means projects located in other geographies—including areas that have been historically disinvested—may be uncompetitive for tax credits.
[3] Regional Housing Revenue refers to the revenue BAHFA collects from general obligation bond issuances, parcel taxes, special head taxes, and gross receipts taxes as defined in AB 1487.

Preservation projects (minimum 15% RHR) may receive funding pursuant to the Program as well.

- **Expand the Range of Financeable Projects.** Much housing development across the region is driven by the requirements of major funding programs, especially tax credits. Alternative project types—such as smaller, infill projects to support lower density development; larger, multifamily rental properties that do not use tax credits; mixed-income housing that includes market and affordable units; and conversion of existing office buildings to residential use—lack available funding. With the Program, BAHFA intends to support a wider universe of project types where needs are not currently being reliably addressed with existing financing sources.
- **Avoid Competitive Bottlenecks in Current State Funding Programs.** Given the current scarcity of affordable housing's principal funding sources—tax-exempt bonds and tax credits—alternative funding pathways are needed for more projects to be possible. The Program is intended for projects that will not seek tax credit funding.
- **Achieve Faster, More Cost-Effective Housing Delivery.** The high cost, extended timelines, and lack of flexibility in pathways to complete new projects are primary contributors to the region's affordable housing shortage. With flexible capital provided through the Program, BAHFA aims to fund projects that:
    - <u>Reduce project costs</u>: Cost reductions can be achieved through a faster pace of development, lower-cost land, innovative construction, and other techniques.
    - <u>Deliver projects at a faster time to market</u>: Faster time to market (acquisition and/or construction through lease-up) can be achieved by, for example, streamlined permitting and approvals, creative construction approaches, and/or streamlined financing, and by providing a pathway for production of large, affordable multifamily rental housing without tax credits.
- **Pilot New, Innovative Approaches.** BAHFA wants to open doors to developers that bring leading-edge ideas to meeting the region's housing needs. By providing flexible capital via the Program, BAHFA aims to prioritize housing production and preservation that pilots or expands on new, innovative approaches. For example, BAHFA

	expects that projects that choose to forgo LIHTC financing and instead prioritize time and cost savings could be funded through the Program, as could projects that explore creative, different community-based ownership structures, or projects that rely on partnership and collaboration between multiple organizations to share capacity and expertise.
Funding Products - Generally	The initial funding products BAHFA will provide pursuant to the Program are intended to support achievement of the Equity Objectives and the Additional Objectives set forth above, and to be responsive to regional financing needs and opportunities.[4] As the region's affordable housing needs evolve, and as BAHFA identifies additional sources of funding and develops additional capacities, the funding products are expected to change. All Program terms will be periodically reviewed and are subject to revision at any time. Exceptions to general Program terms may be available on a project-by-project basis. Initial Program funding products are grouped into three categories: 1. Products available for projects meeting the criteria for **Efficient Delivery**; 2. **Affordable Unit Buy-Down** product; and 3. Products available to **Adaptive Re-Use** projects.
Efficient Delivery Products	To qualify for **Efficient Delivery** funding, projects must: • Minimize their total development cost so that it does not exceed the lesser of $500,000 per unit (adjusted for bedroom count and capitalized operating subsidy needs) or 80% of a comparable project's cost; and • Keep their development timeline from site/building acquisition to lease-up (for new construction projects) to no greater than that of a comparable project, and in no event greater than 3 years; or, for construction/rehabilitation completion (for preservation projects), to no greater than that of a comparable project, and in no event greater than 18 months. Qualifying projects are expected to forgo applying for tax credits, though may be receiving other sources of local, state, or federal subsidy. Preference will be given to projects minimizing permanent subsidy required to be

[4] For additional analysis of regional financing needs and opportunities, please refer to the Appendix.

	provided by BAHFA, while also aligning with BAHFA's other programmatic and policy objectives.[5] Initial funding products available to projects meeting the Efficient Delivery criteria include: • **Permanent Financing** products available pursuant to BAHFA's other funding programs, including Subsidy Loans, First Mortgage Loans, and Conduit Bond Issuance. Subsidy Loans may be funded at permanent conversion, or prior to or during construction. If necessary to support project feasibility, BAHFA may exceed the subsidy caps set forth in its other funding programs. • Flexible financing ("**Efficient Delivery Loan**") to pay for **all or any portion** of eligible acquisition, predevelopment, construction (or, for Preservation projects, rehabilitation) costs until building completion and stabilization. The Efficient Delivery Loan is anticipated to be paid down to the greatest extent possible from other sources at building stabilization, but any remaining balance thereafter may remain as a permanent source. This product is anticipated to be funded from RHR at a below-market interest rate. Typically, BAHFA will require a first-position lien on the property, although this requirement may be waived when supported by the transaction structure and necessary for project feasibility.
Affordable Unit Buy-Down Product	The **Affordable Unit Buy-Down** pays for the cost of adding additional affordable housing units in market rate projects (both new construction and existing market-rate developments) in exchange for 55-year deeded affordability restrictions on these units. Payments would not be available for units that are already required to be affordable, for example, pursuant to an inclusionary housing requirement. For any unit, BAHFA's calculation of the amount it will pay to buy down affordability in a unit will be based on the net present value of the difference in property cash flows with and without the unit affordability restriction; consequently, the amount of the payment BAHFA would provide will vary with market and affordable rental rates across the region.

[5] Where possible, BAHFA will prioritize projects that incorporate extremely low income (ELI) and/or permanent supportive housing (PSH) units. Without federal or state resources such as tax credits, these projects will require increased capital subsidy from local jurisdictions and BAHFA. PSH units will also require operating/rental subsidy and services funding from local jurisdictions. In jurisdictions where operating/rental subsidy or services funding is unavailable, successful projects may still be viable at rents affordable to higher AMI levels.

	The Affordable Unit Buy-Down is provided in the form of a forgivable loan to borrowers, in an amount of up to $200,000 per unit, in exchange for the affordability restriction on their market-rate units.
Adaptive Re-Use Products	The **Adaptive Re-Use Program** provides funding for conversion of non-residential buildings to residential use. Qualifying projects are expected to demonstrate strong alignment with BAHFA's programmatic and equity objectives. Due to their complexity, Adaptive Re-Use projects may have higher per-unit costs and longer development timelines than other BAHFA-funded projects. Initial funding products available to projects meeting the Efficient Delivery criteria include: • **Permanent Financing** products available pursuant to BAHFA's other funding programs, including Subsidy Loans, First Mortgage Loans, and Conduit Bond Issuance. Subsidy Loans may be funded at permanent conversion, or prior to or during construction. Subsidy amounts are subject to a $200,000 per unit cap, with additional amounts available for projects determined to be a high priority based on their meeting criteria to be established by BAHFA. • Construction period financing ("**Adaptive Re-Use Loan**") to pay for **<u>all or any portion</u>** of eligible acquisition, predevelopment, and construction costs until building completion and stabilization. The Adaptive Re-Use Loan is anticipated to be repaid from other sources at building stabilization. This product is anticipated to be funded from RHR at a below-market interest rate. Typically, BAHFA will require a first-position lien on the property, although this requirement may be waived when supported by the transaction structure and necessary for project feasibility.

Included in **Appendix**:

- Current Financing Overview
- Landscape Analysis
- Opportunities for BAHFA
- Funding Scenarios

APPENDIX TO BAHFA PROGRAM DESCRIPTION

INNOVATION PROGRAM

*This **Appendix** includes additional analysis of the regional financing needs and opportunities to which BAHFA's Innovation Program is intended to be responsive.*

Current Financing Overview	Affordable housing is produced and preserved at scale when supported by reliable, predictable funding sources. Across the region, the bulk of the region's affordable housing production and preservation depends on the availability of LIHTCs, supplemented by local subsidy.[6] Additional federal, state and local programs can create opportunities for different types of development, but are much smaller in scale, may be short-lived, and/or may not be as profitable for developers to participate in. Equity from the sale of tax credits to investors typically provides around 40% (for 4% credits) to 60% (for 9% credits) of a project's permanent funding need, so it is a critical component of financing affordable housing alongside subsidy loans. This has created a formulaic, LIHTC-reliant (and correspondingly LIHTC-limited) system for affordable housing production and preservation that is not able to keep pace with the demand for affordable units. The resources needed to sustain this system are also increasingly scarce: although 9% tax credits have long been competitive, allocations of tax-exempt private activity bonds with as-of-right 4% tax credits, once widely available, are now oversubscribed. The initial feasibility assessment of an affordable housing project can hinge on whether it is expected to be competitive for tax credits and private activity bonds; and increasingly, projects across the Bay Area struggle to be competitive due to their high costs. As projects become more expensive, it also means that available tax credits can support fewer projects. Projects that are unable to secure a tax credit award in their first or successive funding rounds incur carrying costs and become increasingly expensive, for both developers and the local jurisdictions that provide subsidy to projects. Increasing costs and competition for tax credits is also constraining where projects can be located. To offset higher costs, developers prefer projects that are located in federally-designated Qualified Census Tracts and Difficult to Develop Areas that provide a "basis boost," increasing the value of the tax credit by 30% compared with projects located in ineligible areas. The California Tax Credit Allocation Committee (CTCAC) scoring system also currently awards additional points to LIHTC projects that are located in

[6] For an expanded discussion of the role LIHTCs and other sources play in affordable housing production and preservation, please refer to the Multifamily Rental Production Program and Regional Anti-Displacement and Preservation Program descriptions.

	highly-resourced “Opportunity Areas,” increasing their competitiveness to be funded, while de-prioritizing projects that would be located in areas that have high segregation and poverty. Although the methodology and role of opportunity mapping is currently undergoing re-assessment, and may be changed for later funding rounds, it currently means that many projects that are a priority for BAHFA—for example, projects that address systemic racism in housing and support wealth building but may be located in areas that are not assessed by CTCAC to be “high opportunity”—may need to be funded without leveraging tax credits. The limitations of the current, tax credit-reliant system for funding affordable housing have caused jurisdictions to seek alternative financing sources that could be scalable, reliable, and predictable and support a wider range of project types in a broader set of geographies than those most competitive for tax credits; as well as “off-ramps” that could support projects moving forward even when they are unsuccessful in securing tax credits.

Landscape Analysis	Numerous “innovation funds” have sprung up around California and elsewhere, seeking to spark new ways of creating housing more quickly and at lower cost. These include, among many others:
	• **Various programs in Los Angeles**, at both the city and county level:
	  ○ **Proposition HHH Housing Challenge.** In 2019, Los Angeles Housing and Community Investment Department (HCIDLA) set aside \$120 million of LA City’s \$1.2 billion homeless housing bond funded from Proposition HHH for the construction of low-cost and innovative permanent supportive housing (PSH), including onsite services, for extremely low income (up to 30% of AMI) and very low income (up to 50% of AMI) households. The primary goal was to identify innovative construction and financing models to produce approximately 1,000 new supportive housing units within two years after receiving funding approval.
	    ▪ Funding on the Housing Challenge projects ranged from \$600,000 to \$13 million and was in the form of a subordinate loan to projects. Eligible project costs included acquisition and/or construction related activities, and to be eligible for an HHH Housing Challenge award, projects had to meet criteria related to the project’s cost efficiency and shortened construction timeline, incorporation of certain design features and community engagement, and

		representation of innovation in meeting the city's homelessness crisis. ▪ 15 projects by six developers were awarded under the Prop HHH Housing Challenge program between May 2020 and June 2021, totaling 867 units and $96.4 million in HHH loans with an average award of $6.4 million per project. By July 2022, according to the Los Angeles Housing Department's progress report, only 1 of the 15 projects closed the loan within 12 months of award and 5 others closed between 15 and 22 months from award, resulting in 349 units that have started construction. Considering this and their estimated occupancy date, only 1 was expected to be completed within 30 months of award. Positively, of the six projects that were under construction, the average cost of the Housing Challenge units was approximately $450k, compared to $596k (in 2021) for standard HHH funded units. ▪ Related to the delays, the LA Controller released a report in February 2022 – "The Problems and Progress of Prop. HHH"– which included a number of takeaways for the HHH program (including the Housing Challenge projects): [7] • HHH provided *partial* funding to each project - developers still had to seek additional subsidy loans from other sources as well as tax credits and bonds after the HHH award. Although this enabled Prop HHH to fund more projects, the process of securing multiple sources typically adds time and costs to each project; • The COVID-19 pandemic contributed to spikes in construction costs, government staffing shortages, and extended funding and review timelines;

[7] "The Problems and Progress of Prop. HHH," Office of Kenneth Mejia, LA City Controller, February 23, 2022, https://controller.lacity.gov/audits/problems-and-progress-of-prop-hhh.

- The report highlighted longstanding challenges with timely and efficient permitting processes and recommended the City of LA speed up its review of HHH projects;
- To counter rising construction costs and land use issues, it recommended that the City acquire and convert existing buildings (such as hotels and newly built apartments) to housing; and
- For Housing Challenge projects specifically, it noted that some projects had issues with site control (since awards were made beforehand) which caused cancellations and developers securing other financing.

- Salient lessons BAHFA can learn from these takeaways for its Program includes: supporting projects that have streamlined permitting processes, narrowing down the number of financing sources on each project, and piloting new approaches to deliver affordable housing such as adaptive re-use of existing buildings.

- **LA Housing Innovation Challenge.** The LA County Homeless Initiative launched the Housing Innovation Challenge in 2019 to support projects preventing homelessness throughout the county. The Challenge[8] offered an award of $500,000 or $1 million in the form of a forgivable loan from a $4.5 million fund up to five creative, scalable, and low-cost supportive housing projects and programs. The projects had up to 2 years to complete and were evaluated based on their creativity, achievability, and replicability. Organizations that received awards included modular and shared-living developers, as well as a program incentivizing homeowners to add accessory dwelling units (ADUs) to their properties. The impact and results of these projects include:
  - Flyaway Homes LLC: In July 2022, Flyaway Homes LLC unveiled its permanent supportive housing development, producing 16 two-bedroom units from

[8] "Housing Innovation Challenge," Housing Innovation Challenge, https://www.housinginnovationchallenge.com/#about.

a total of 54 converted shipping containers.[9] In addition to the $1 million award received, the development was predominantly funded by private capital.

- Restore Neighborhoods LA's Bungalow Court: Eight one-bedroom studio units were completed in early 2021, financed partially by the $500,000 innovation award, along with broad range of private capital. [10]

- **California Investment and Innovation Program.** Representing an alternative approach to innovation from the two programs created in Los Angeles discussed above, the recently passed Senate Bill 193[11] established the California Investment and Innovation Program, a $50 million fund to grant awards to enhance the capacity of Community Development Finance Institutions ("CDFIs") in providing technical assistance and capital access to economically disadvantaged communities. With annual appropriated funding, the program can offer up to $15,000,000 in total grants per calendar year to eligible applicants (current CDFIs with minimum net worth and portfolio requirements, with either an office, officers currently residing in, or a record of lending in California) selected by the State to apply for funding. Broadly, the Program's funding may be used to increase the CDFI's net assets or to increase its working capital. The first round of grants is expected to be awarded by February 2024.

- **Homes for the Homeless Fund.** In San Francisco, the Housing Accelerator Fund, a CDFI, established the Homes for the Homeless Fund with the goal of producing a new PSH project in less than three years from site acquisition and at a 25% lower total development cost than comparable projects. Its prototype project, the Tahanan, located at 833 Bryant Street, used $50 million in philanthropic funding to pay for all predevelopment, acquisition, and construction costs on an accelerated basis, so that development could proceed even without knowing whether the project would be awarded tax

[9] "FlyawayHomes and the People Concern Announce 82nd Street Permanent ...," July 22, 2021, https://www.einnews.com/pr_news/546974510/flyawayhomes-and-the-people-concern-announce-82nd-street-permanent-supportive-housing-reveal.

[10] Anna Scott, "La Developer Finds a Way to Build Affordable Housing Cheaper. Is This a Model for Others?" March 22, 2021, https://www.kcrw.com/news/shows/greater-la/affordable-housing-oscars-oc/restore-neighborhoods-la-homeless-housing.

[11] "SB-193 Economic Development: Grant Programs and Other Financial Assistance.," California Legislative Information - Today's Law as Amended, June 30, 2022, https://leginfo.legislature.ca.gov/faces/billCompareClient.xhtml?bill_id=202120220SB193&showamends=false.

	credits and whether funding to operate the building as PSH would be available from the city. The project succeeded in achieving its cost and timing goals. At permanent financing conversion, a portion of the philanthropic funding was left in the project ($8 million), with tax credit equity, permanent debt supported by 30-year lease payments from the city, and operating subsidies comprising the balance of permanent sources. Had the project not been awarded tax credits, or received a lower lease payment from the city, additional philanthropic funds would have had to remain in the project. • **Adaptive Re-Use.** Numerous cities, among them Calgary, Cleveland, Atlanta, and Washington, D.C., are launching programs and incentives designed to fund and fast-track conversion of underutilized downtown office buildings to housing. In many of these cities, long-term decline in demand for office space was compounded by the COVID-19 pandemic, even as demand for affordable housing continued to grow. Adaptive re-use of these existing buildings can re-knit and animate neighborhoods that have become pocked with office vacancies and can be more environmentally sustainable than ground-up new construction. Conversions can be expensive, and every building presents unique challenges, but costs can be reduced through measures such as coordinated, streamlined permitting and dedicated assistance with meeting building code requirements. In Calgary, a 10-year, $1 billion ($721 million USD) initiative was recently launched to revitalize a targeted area of the downtown core, with 40% of funding dedicated to providing subsidy for office conversions, up to the lesser of $54 per square foot or $7.2 million per project, with greater funding available subject to additional review and approval. As of October 2022, five conversions anticipated to produce 707 units of housing had been approved. In California, new statewide legislation has been under consideration that would provide funding specifically for adaptive re-use; such a funding source, if it were to become available, could augment any funding BAHFA provides for this purpose. In general, the above programs reflect the urgency to establish viable, scalable new models for creating and preserving affordable housing. Many of these programs focus on creating housing for especially vulnerable households and individuals that are, or are at risk of becoming, homeless; but innovative ideas from these and other efforts can be brought to bear on and scaled more sustainably, with less reliance on scarce operating and

	service funding, through their application to additional housing types such as rental housing for a mix of affordable income ranges.
Opportunities for BAHFA	BAHFA has the opportunity to support production and preservation projects outside of the traditional, tax credit-centric financing models and support the delivery of housing that is cost-effective and on a faster timeline to meet the region's housing needs. Alongside its funding programs for production and preservation that seek to leverage other financing sources, including tax credits, there is a need for an additional program designed to support projects that can either be developed at significantly lower cost and delivered to the market at a faster timeline, or those that don't necessarily readily fit within the parameters for BAHFA's other funding programs. With this Program, BAHFA will provide capital that is flexible and able to fill developers' financing needs at several stages over their projects' lifecycles. <u>It is anticipated that projects receiving funding from the Program will not expect to use tax credits.</u> This does not mean that the Program is intended for projects that were unsuccessful applicants for tax credits (which could still be funded through BAHFA's other funding programs, subject to the terms of those programs) or that the Program will not support projects that have a tax credit allocation; it means, instead, that projects are more likely to be able to achieve significant cost and time savings and greater innovation, and more likely to be aligned with BAHFA's equity and other programmatic goals, if they decide, from the start, not to depend on tax credits. However, the tradeoff for encouraging more innovation and creativity without being bound by the parameters of the tax credit program will be the need for more subsidy loans—whether from local jurisdictions, other public agencies, or BAHFA—to fill the permanent funding gap. The Program will be initially funded by Regional Housing Revenues, which will likely be raised through general obligation ("GO") bonds. GO bond proceeds can only be used to pay for direct project, capital costs. Other innovation programs have been piloted in California that focus on providing technical assistance funding and working capital support to nonprofit developers and CDFIs, but this is not anticipated to be an element of BAHFA's Innovation Program if it is capitalized with GO bond proceeds. However, it is BAHFA's goal to diversify its sources of funding over time and correspondingly expand the types of funding it can provide. Emphasis is given to minimizing the long-term, permanent subsidy funding BAHFA would need to provide to any one project, since BAHFA will seek to recycle its flexible early-stage capital into additional projects as possible. This will tend to favor projects that have a lower ongoing subsidy need due to either higher in-place rents, or for extremely low-income projects, local

	jurisdiction capital subsidies, local jurisdiction operating subsidies, local jurisdiction abatement lease (lease payments from which can be applied to servicing permanent debt service), or state-funded programs such as the Housing Accelerator Program. In addition, whenever possible, BAHFA will look to encourage co-lending or funding by the local jurisdiction so as to reduce BAHFA's funding per project and thereby allow BAHFA to support a greater amount of projects overall.
Funding Scenarios	As stated under Program Objectives, 67% of RHR is required to be allocated to Production and Preservation with an additional 18% available to fund any of the 3Ps. This RHR will be further sub-allocated across the Innovation Program, the Multifamily Rental Production Program, and the Regional Anti-Displacement and Preservation Program. Assuming $2 billion in RHR becomes available to BAHFA pursuant to a GO bond measure, up to 85% would be available for Production and Preservation Programs, drawn in five anticipated tranches at three-year intervals (though funding may be drawn on an accelerated basis if the region expends funds more quickly). Funding for the Program will in part be influenced by demand for BAHFA's other production and preservation funding programs. In addition, current economic conditions and leveraged funding availability could result in the Program supporting several times its allocated funding. While BAHFA's funds provided through the Program will be flexible and are able stay in projects long-term if needed, a portion of funds provided as early-stage, construction financing ideally will be repaid, and BAHFA will be able to revolve these funds to support additional projects.