LISC
LOCAL INITIATIVES SUPPORT CORPORATION

August 26, 2024

Mr. Andrew Schlack
Program Manager, Capital Magnet Fund
Community Development Financial Institutions (CDFI) Fund
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

RE: Capital Magnet Fund – Interim Final Rule Request for Public Comment

Dear Mr. Schlack:

The Local Initiatives Support Corporation (LISC) thanks the CDFI Fund for the opportunity to provide feedback on proposals to improve the Capital Magnet Fund (CMF).

Established in 1979, LISC is a national nonprofit housing and community development organization and community development financial institution (CDFI) dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity. LISC mobilizes corporate, government, and philanthropic support to provide local community development organizations with loans, grants, and equity investments; as well as technical and management assistance. Our organization has a nationwide footprint, with local offices in 37 cities. In 2023, LISC invested approximately $2.8 billion in these communities. Our work covers a wide range of activities, including housing, economic development, building family wealth and incomes, education, and creating healthy communities.

I) General Comments

LISC is broadly supportive of the revisions to the Capital Magnet Fund's interim rule and we provide specific comments and feedback on them below. Many of these changes are recommendations that LISC and others have provided to the CDFI Fund based on our history of administering CMF resources. We appreciate the time and effort Treasury has put into improving the program over time and note that many of the changes in the new regulation will be further outlined in future sub-regulatory guidance, funding notices, and revised assistance agreements. It's essential that the CDFI Fund continue to engage stakeholders as those documents are revised since they will determine how much of the regulatory changes are implemented.

As Treasury continues to work on sub-regulatory efforts, we believe it's important to keep in mind that the key component of the CMF's program success, and what makes it distinct from other federal affordable housing programs, is the enterprise level nature of the funds. This structure allows the deep leveraging and flexibility to respond to local housing market needs. CMF funds have been utilized throughout the country, leveraging public and private funds to develop, preserve, rehabilitate, or purchase affordable housing, as well as related economic development activities such as day care centers, community health clinics, and workforce development centers. As the Fund revises program guidance and other materials, we encourage Treasury to keep the funding as flexible as possible, while ensuring awards are utilized as proposed by Applicants. Imposing excessive administrative and compliance requirements on a program which is often a small but crucial component of total affordable housing development costs will ultimately make the program less viable and less attractive to potential applicants, thereby decreasing its impact.

LISC believes that the current administrative complexity of the CMF program often leads it to being underutilized by CDFIs and nonprofit housing organizations. For instance, the CMF program is open to all CDFIs engaged in housing lending, local governmental housing finance agencies, and most nonprofit housing organizations. However, the CDFI Fund receives only approximately 140 applications per award around, and the numbers have been decreasing over time. We believe that certain elements of program design and compliance requirements that have been instituted by the CDFI Fund mainly through sub-regulatory guidance has dampened demand for the funding and also limited the ability of the CDFI Fund to allocate these resources for sorely needed affordable housing projects.

This complexity also leads to high rates of CMF non-compliance although awardees are not told the impacts of that status. The compliance concerns for many awardees extend beyond the CMF program. Many CMF awardees are CDFIs that are also applicants for CDFI Program awards, New Markets Tax Credit allocations, and CDFI Bond Guarantee financing. Because non-compliance in any one CDFI Fund award program can disqualify an applicant from receiving funding under another program, it is likely many Recipients with compliance problems are dissuaded from future applications for fear of jeopardizing awards from other CDFI Fund award programs. We recommend the Fund provide as much guidance as possible on the impacts of CMF non-compliance, so the sanctions are understood by Recipients and the public.

We believe the lack of demand caused by the program's intricacy is also a contributing factor to the CDFI Fund's decision to not fully award all the funding in the current and previous funding rounds. LISC does not support holding back award funding if there are qualified applications available and we believe this is inconsistent with the Administration's Housing Supply Action Plan, which seeks to maximize federal housing programs to address our nation's affordable housing crisis.

To ensure that all organizations are able to compete for funding, we continue to suggest that the CDFI Fund create a separate application category for smaller applicants and allocate no less than 10 percent of that year's assessment for these groups. There's precedent for this activity since the CDFI Program has included a smaller applicant set-aside for many years, which helps ensure award funds reach these organizations. Applicants under this set-aside should still have to meet all programmatic requirements although would importantly compete against each other versus larger organizations.

To further support CMF award recipients, including smaller organizations, we recommend that the CDFI Fund utilize appropriations for its Capacity Building Initiative to provide training and technical assistance on the CMF Program. HUD regularly provides such assistance on its federal housing programs, which allows award recipients to build their understanding of program requirements and ultimately achieve greater impact in their community. Dedicated and ongoing CMF training and technical assistance may also grow the application pool since potential award Recipients will know there will be support provided as program and compliance questions arise.

II) Specific Comments

LISC offers the following comments on the new CMF interim rule.

A. CMF Alignment with Other Federal Affordable Housing Programs

The revised interim rule institutes a new Presumptive Compliance standard, where certain CMF projects that are also funded under other federal housing programs are presumed to be compliant with CMF rules.

The regulation doesn't outline what federal housing programs or standards will be included to meet the Presumptive Compliance rule although recent public communications from the CDFI Fund indicate that guidance will be published after the end of this public comment period.

LISC supports the new Presumptive Compliance standard since CMF awards are a vital although often small percentage of total development costs. Duplicative or discrete administrative requirements increases burden to award recipients and ultimately increases costs for projects with limited other subsidies. In addition, streamlining federal housing programs is in line with the Administration's Housing Supply Action Plan, which calls for agencies to lessen duplication between federal housing programs.

LISC recommends that the CDFI Fund should provide safe harbors in the forthcoming guidance with respect to compliance practices for investments in properties that are financed with, or will be taken out by Low-Income Housing Tax Credit (LIHTC) investments. These projects are already heavily regulated and monitored by state housing finance agencies, and in all circumstances, have a much longer extended use period than is required under the CMF Program.

Recipients that utilize CMF awards in LIHTC properties should be assumed to meet affordability and rent requirements and categorized as Affordable Housing Activities. This is important since the compliance monitoring of LIHTC properties with program requirements (health and safety standards, rent ceilings, income limits, and tenant qualifications) are already overseen by the state housing finance agencies. We note that the CMF rent requirements are already set at LIHTC rent limits. Projects which receive CMF are subject to 10-year affordability requirements and should be presumed to meet that requirement if it's a property with Housing Credits or other subsidies which already include a use restriction longer than that term. In those instances, a separate CMF declaration of covenants should not be required. Similarly with respect to property standards, state Housing Finance Agencies engage in rigorous oversight over the condition of LIHTC properties, such that LIHTC investments should also be given a proxy consideration for satisfying physical property conditions.

The CDFI Fund does not release data on how CMF resources are utilized, unlike other award programs administered by the Fund. This doesn't allow stakeholders to understand what other capital sources are utilized in CMF supported projects or the impact of the program. We recommend the CDFI Fund release the most granular CMF compliance data possible, with unique identifiers included where there are privacy concerns, so the public understands where and how these subsidies are being utilized.

Based on our usage of CMF awards, we know that many affordable rental housing priorities we finance also have federal funding through LIHTCs, HOME Investment Partnership Program, and operating resources through Section 8 Project Based-Vouchers and Project-Based Rental Assistance. These and other similar federal affordable housing programs should be included under the Presumptive Compliance standard.

B. Affordable Housing Preservation

The interim rule's Preservation definition appropriately provides flexibility when using CMF subsidy for those projects. The definition though states (emphasis added): "Preservation may include the refinancing of owner-occupied Single-family housing or Multi-family rental housing *to extend the existing affordability restrictions set to expire during the Investment Period*, or other timeline as defined by the CDFI Fund, by at least an additional 10-year Affordability Period or as set forth in the Assistance Agreement."

LISC recommends that the CDFI Fund only require a 10 year affordability period for preservation transactions and remove from the definition references to restrictions set to expire during the Investment Period. This is needed since it's unclear from the current language if a preservation project needs to have *an expiring use agreement during the CMF compliance period. We believe simply mandating 10 years of affordability is sufficient for all preservation activities, regardless of CMF compliance timing.*

C. Income Limits

The new CMF regulation changes the Very Low-Income (VLI) standard from 50 percent of area median income (AMI) to 60 percent AMI. This is important for rental housing since CMF is often utilized with LIHTCs, which includes a 60% VLI standard.

LISC supports this alignment since it will standardize requirements and reduce Recipient burden.

The CDFI Fund states it will no longer require annual tenant income recertifications for projects where 100 percent of the units are subject to CMF affordability restrictions and the Fund will provide additional information in future Assistance Agreements.

LISC supports efforts to reduce burden associated with reporting tenant income while ensuring only income qualified families occupy CMF supported units. Currently, tenant income is re-examined annually to determine if the family remains income eligible.

Tenant income requirements differ by federal programs for affordable housing production and preservation and rental assistance programs, such as Section 8. This is since production and preservation programs like LIHTC and CMF conduct checks for compliance purposes versus setting subsidy levels for Section 8 rental assistance. LISC supports exempting 100% low-income rent restricted LIHTC buildings from annual tenant income recertifications. In addition, we support it more broadly for any LIHTC supported unit since that data is already being collected and submitted to the state allocating agency.

We understand that the CDFI Fund needs assurance that award Recipients are meeting the income targeting they proposed in their application and which flow to the CMF Assistance Agreement. Recipients should attest to that in their reporting during the Investment Period although not be required to report on an ongoing 10 year basis if the units are supported by LIHTC or another subsidy program (such as Section 8) with similar income targeting requirements, since this is duplicative.

D. Service Area

The interim regulations update the Service Area definition to state: "geographic area in which the Applicant proposes to use the CMF Award, and the geographic area approved by the CDFI Fund in which the Recipient must use the CMF Award as set forth in its Assistance Agreement. Service Area may include a national Service Area for Rural Areas and additional areas that may be defined by the CDFI Fund in the applicable NOFA."

LISC appreciates the CDFI Fund including a national Service Area for Rural Areas in the new regulation, since this will broaden the reach of these resources into rural communities. Currently, CMF applicants can commit a percentage of their award for projects in rural communities in a 15 state Service Area. If awarded, Recipients are held to those commitments, and with rural projects in particular, it may be difficult to find projects meeting specific CMF requirements in a limited geographic area.

LISC recommends the CDFI Fund define a national rural Service Area in the Assistance Agreement to allow for the use of CMF subsidy in any rural defined place, allowing awardees additional flexibility. This could be structured as an individual Service Area within the overall 15 state limit or any rural place, regardless of a Recipient's Service Area. This is important since it's difficult for applicants to know at the time of application where they will get rural deals years down the road. And for groups with large rural footprints, this should spur more rural lending since those applicants would be more confident in serving broader geographies instead of winnowing rural activity to the current subset of a 15 state Service Area.

E. Commitment Deadline. The interim rule changes Committed for Use to mean committing funds to an eligible CMF use within two years. Recipients must then make a Project Commitment within three years of receiving an award. This change allows one additional year to source qualified projects during the Investment Period.

LISC supports this change although believes the bigger challenges for Recipients are with the other compliance milestones. These are not based in statute or regulation and instead are a construct of the annual funding notices and Assistance Agreements.

The CMF program will now require Recipients to commit funds for an eligible use within 2 years; make a Project Commitment within 3 years; complete projects within 5 years; and place projects into service no later than six months after project completion, with initial occupancy within 12 months of completion. This structure, specifically the project completion and placed-in-service requirements, make using CMF for early-stage predevelopment and acquisition lending difficult, especially in areas where LIHTC is oversubscribed, and it can take years to secure all necessary project funding.

LISC continues to recommend that the CDFI Fund update these requirements so construction has to commence within five years of the award date, rather than require project completion by that time period. Under this structure, affordability covenants would be recorded within the five year compliance period, confirming that units were in production, with a very high likelihood of project completion. Current placed-in-service deadlines push recipients to lend at later stages with lower leverage, since many put in higher loan amounts for construction and permanent debt. A CMF subsidy would be more valuable as early stage lending where it is difficult to find conventional sources than later stage financing.

F. Program Income. The revised regulation doesn't include changes to Program Income and notes any changes will made through revised Assistance Agreements. The CDFI Fund has indicated that Program Income will now be allowed for all eligible CMF affordable housing activities and that Assistance Agreements will be revised accordingly.

LISC supports relaxing CMF Program Income requirements, since we believe they are excessive in scope compared to other CDFI Fund programs, as well as with OMB requirements and unduly heighten incidences of non-compliance, since the awardee is: (1) required to line up the perfect mix of projects (with respect to income targeting, leveraging, etc.) in a compressed reinvestment period, (2) subjected to an extended compliance period of ten years beyond the placed in service date of the newly financed projects, which could in theory extend the life of the award agreement by an additional nine years; and (3) cause awardees to modify investment behavior in a non-productive manner in order to minimize risks of non-compliance (e.g., by artificially lengthening the term of initial investments; or by selecting projects based on readiness more than subsidy need).

We appreciate that in FY 2021 the CDFI Fund allowed Program Income to be utilized outside of a Recipient's Service Area. LISC supports that flexibility and the CDFI Fund's indication that Recipients can utilize PI for any eligible use. We also recommend that the CDFI Fund revert to only requiring Program Income requirements until year 4 of the award agreement. While OMB requires Program Income requirements as a part of its Uniform Administrative Guidance regulation, Treasury has discretion on how it's implemented programmatically. This is evident by how the CDFI Fund utilizes a PI definition for the CMF Program that is different than the OMB 2 CFR 200 regulation. Lastly, we also recommend a Program Income threshold of $500,000 since it's better reflective of the amount of CMF subsidy utilized for projects.

G. Affordable Homeownership Purchase Price Limitation. The previous CMF Interim Rule set the purchase price limitation for a single-family home at 95% of the median purchase price for the area, as used in the HOME Investment Partnership program. This created challenges for CMF recipients trying to support homeownership opportunities for low-income households in high opportunity areas. The new regulation updates the standard so it must not exceed the purchase price limits for areas under the FHA Section 203(b) Mortgage Insurance Program, or other index included in the Assistance Agreement.

LISC supports updating the standard to the FHA Section 203(b) since this should allow more opportunities to utilize CMF for affordable homeownership projects. The 203(b) data is updated more frequently, providing current and accurate data while maintaining affordability measures. Adopting this data would be beneficial to both urban and rural communities, still maintaining affordability, without exceeding a families' financial capacities and opening more homeownership opportunities. The revised regulation also allows other indices as defined the award agreement. If that's included in Assistance Agreements going forward, we recommend a home purchase price standard equal to four times the area median income, a level broadly affordable to families well within the CMF's Eligible Income cap of 120 percentage of AMI. This is same purchase price ceiling for the proposed Neighborhood Homes Investment Act (S. 657 and H.R. 3940), a bipartisan, bicameral bill supported by the Administration that would build and substantially rehabilitate 500,000 ownership homes in distressed communities.

<u>H. Affordable Homeownership Affordability Restrictions.</u> The new rule modifies affordable homeownership compliance by requiring recoupment and replacement of single family housing when resale to an unqualified homebuyer occurs during the first five years after the date of purchase. When the resale to an unqualified homebuyer occurs during year six through the end of the Affordability Period, the CMF investment must be recouped proportionally; however, the Recipient is not required to replace the sold housing unit with another unit. Recoupment of the CMF investment is Program Income, as described in the Assistance Agreement.

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LISC supports shortening the 10 year affordability requirement for affordable homeownership uses to five years. Once a home is sold to an eligible homebuyer (or an existing owner's home is rehabilitated), the CMF Recipient has no effective control of the property or the ability of the reselling owner's ability to repay. Resale restrictions – especially for 10 years – may be confusing for homebuyers/owners, and especially first-time homeowners barraged by an avalanche of paperwork associated with the purchase and financing. Moreover, excessive restrictions may discourage prospective buyers seeking to enjoy the usual unrestricted benefits of homeownership.

The 10-year resale restriction is excessively burdensome for CMF Recipients. There are many reasons why recoupment may not be possible – or even desirable or appropriate - especially if development costs exceed the home's resale value, as may often be the case in low-income areas. It is not reasonable – and discouraging to prospective Applicants – that a Recipient should assume the uncertain and incalculable risk that it might have to reach into its own pocket if it cannot recoup funds that may not even be available.

A better alternative would be to apply the standard included in the previously noted Neighborhood Homes Investment Act. In this structure, an owner selling within five years of acquiring the home must repay a declining portion of their "gain"1 (profit). The repayment obligation equals 50% of gain within the first year and phases out linearly over five years. The repayment obligation would be recorded as a lien, so it will be identified in a standard title search and satisfied at the point of resale. This approach protects against flipping, while also ensuring that homeowners will always have positive home equity, which is important to wealth-building. It also protects mortgage lenders, who want owners to have equity so they will maintain and improve their homes. In a CMF context, this repayment should be treated as PI.

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[1] Under the tax code, the concept of gain reflects the resale price minus the sum of the initial purchase price, the cost of subsequent improvements, and selling costs.

I. Other Affordable Homeownership Recommendations. CMF usage for affordable homeownership activities is much less than rental housing. We recommend that the CDFI Fund continue to reform the program at the sub-regulatory level so that all CMF eligible housing activities are evaluated the same.

LISC recommends that the CDFI Fund release a report to the public which provides application summary statistics so stakeholders can understand if homeownership proposals are being funded in proportion to their representation in the application pool. In addition, we recommend the CDFI Fund release impact data from all previous CMF funding rounds, and release such data on an annual basis, similar to other CDFI Fund administered programs. LISC also recommends that the CDFI Fund create a separate CMF application for homeownership proposals, if those applications are currently disadvantaged, and score and rank them separately.

LISC also recommends that the CDFI Fund remove income targeting prioritization for homeownership applications. Currently, most CMF homeownership Recipients commit to using the award for families making 80 percent or less of area median income, which works in some communities, although not as well for moderate to higher income places. This dampens demand and contributes to the challenge of developing affordable homeownership opportunities. Instead, we encourage the CDFI Fund to look more qualitatively at the overall application, such as strategies that link financing with referrals from housing counseling agencies and to downpayment assistance programs, will score more favorably.

We thank the CDFI Fund for the opportunity to offer suggestions and welcome opportunities to explore these and other possible improvements to the Capital Magnet Fund Program. Please contact Mark Kudlowitz (mkudlowitz@lisc.org), LISC Senior Director of Policy, if you need additional clarification or follow up on any of the recommendations provided in this letter.

Sincerely,

Matt Josephs
Senior Vice President for Policy