MHSA Housing Program
Overview and Lessons Learned (2008-2016)

Overview

The voters of California approved a 1% tax on income over a million dollars in 2004, via Proposition 63, to help provide services for residents with mental illness. A portion of these funds were dedicated to housing, via the Mental Health Services Act (MHSA) Housing Program, in May of 2008.

The MHSA Housing Program was a state-wide program administered jointly by the California Department of Mental Health (DMH) and later by the Department of Health Care Services (DHCS) and the California Housing Finance Agency (CalHFA) per the terms of an 8-year Interagency Agreement using a one-time MHSA appropriation of $400 million shared by 51 participating mental health agencies. The participants assigned their MHSA funds to DMH, who assigned them to CalHFA who administered the funds on behalf of the mental health agencies (MHAs). Initial plans were to supplement the $400 million with ten more years of annual appropriations totaling $75 million; however, the Counties petitioned to have the future funding requirement removed from the proposal just prior to the implementation of the MHSA Housing Program.

The MHSA Housing Program funds financed the development of new housing opportunities for seriously mentally ill clients and their families who were either homeless, or at risk of being homeless. The MHSA Housing Program published a Term Sheet in 2008, following extensive stakeholder feedback and input from the County Behavioral Health Director's Association, DMH, and other local and state agencies and private organizations.

The terms of the MHSA Housing Program:

- Allowed financing of rental or shared housing (where MHSA clients rent bedrooms in a single family home or 1-4 unit building)
- Established minimum development team experience requirements
- Provided MHSA clients with fully-furnished units and affordable rents, taking into consideration income from SSI/SSP
- Maximum rents not to exceed 30% of 50% of Area Median Income (AMI)
- No minimum or maximum income restrictions
- Provided MHSA financing at start of construction or as permanent take-out financing once units were built and occupied
- Provided residual receipt loans limited to the lesser of 30% of MHSA unit development costs or $100,000 per unit (limit increasing by 4% annually)
- Provided a Capitalized Operating Subsidy Reserve (COSR) of up to $100,000 per MHSA unit (limit increasing by 4% annually) when other project-based subsidies were not available

- COSR-subsidized units charge minimum rents equal to the higher of 30% of SSI/SSP or 30% of household income (less utility expenses)
- COSRs were originally sized to last 17-20 years assuming inflation rates of 2.5% for income, 3.5% for operating expenses and a 10% vacancy rate for the MHSA regulated units, plus up to 12 months of MHSA rental income to cover the rents of MHSA clients moving in without a source of income
- Participating MHAs had to commit to provide wraparound supportive services for the MHSA clients for the life of the MHSA loan
- Established minimum required operating and replacement reserves
- Required annual MHSA reporting requirements to both CalHFA and DHCS
- Provided a Term Sheet waiver approval process

MHAs generally solicited housing proposals through a local over-the-counter process or through a competitive request for housing proposals. The goal of each MHA was to award funds to those projects that best leveraged the limited MHSA resources, while still meeting the need to create permanent supportive housing opportunities across the state, while providing greater accessibility and integration of housing in communities (as opposed to approving high density segregated housing proposals that would further promote stigmas, isolation and community opposition).

The local MHA approval process included the requirement for a local peer review process, 30-day publication of the Development Information and prescribed Supportive Service Plan for public comment and local Board of Supervisors' approval before proposals were forwarded to DHCS and CalHFA for further underwriting.

Smaller counties often faced limited development options due to limited allocations of MHSA funds, and many partnered with a local housing agency or housing authority to pool their knowledge base and resources.

Additional small county obstacles included:

- Lack of housing proposals from experienced developers
- Lack of alternate funding sources required to make larger development proposals financially viable
- Lack of MHSA funds to provide adequate funding to develop or subsidize more units and provide funds to pay for more tenant security and utility deposits
- Lack of affordable land or housing in close proximity to existing mental health clinics or service providers
- Lack of funds to help small housing development firms pay for pre-development costs (purchase offer deposits, appraisals, building inspection reports, environmental reports, preliminary architectural plans, or costs of hiring a contractor to provide a comprehensive scope of work)

As a condition of the funding, each Borrower was required to negotiate and provide a comprehensive Memorandum of Understanding (MOU) between the MHA, primary service provider (which may be the MHA), and the developer's selected property management firm. The MOU addressed the process for MHSA client referrals waiting list protocols and the various roles and responsibilities of each party.

Financed developments received residual receipt loans in exchange for accepting occupancy restrictions outlined in a regulatory agreement. As the initial COSRs were only funded to last 17-20 years, the MHAs assumed they could rely on the loan payment revenue stream to recapitalize the COSRs when developers typically refinance and renovate projects after the initial 15-year tax credit compliance period. As a result of ongoing MHA, developer, and property management personnel turnovers DHCS and CalHFA anticipates the need to provide training for these staff for the life of the MHSA loans so new staff understand the occupancy and reporting requirements of the MHSA Housing Program.

End of Program Statistics

Over eight years, the MHSA Housing Program committed approximately $391 million for housing development proposals that will provide over 2,500 new housing opportunities for MHSA-eligible clients by the time all units are built in 2018.

- Over $267 million in MHSA financing was approved for capital development loans for 184 projects that include over 2,500 regulated units funded by average MHSA contributions of $105,000 per unit. The MHSA funds leveraged sufficient public, local, state and federal funding to develop over 10,100 units with average statewide total development costs of:
    - $220,000 per acquisition/rehab unit
    - $345,200 per newly constructed unit
    - $395,500 per unit for projects that involved acquisition/rehab and new construction
- The overall average development cost per unit was $304,400
- Over $122.5 million was approved for COSR's to subsidize 59% of the MHSA regulated units at an average subsidy of $81,240 per unit.

Project Statistics

- 65% involve New Construction
- 35% involve Acquisition/Rehabilitation
- 12.7% restrict the MHSA units to only Seniors (55+)
- 6.5% restrict the MHSA units to only Transitional Aged Youth
- 65% relied on Tax Credits (54% used 9% credits; 22% used 4% credits)
- 12% were Shared Housing Projects (MHSA clients rent bedrooms)
- 2% specifically serve MHSA eligible veterans (3 Projects)
- Over 90% of the projects regulate all rents to less than 60% of AMI, with at least 78% of the total units developed, regulated to families earning less than 40% of AMI.

Of the 184 projects financed, the five counties with the greatest number of projects are:

- Los Angeles, with 37 projects and 829 MHSA units
- Alameda, with 14 projects and 95 MHSA units
- San Diego, with 14 projects and 229 MHSA units
- Santa Clara, with 12 projects and 113 MHSA units
- Orange, with 11 projects and 160 MHSA units

Lessons Learned

Mental Health Agency (MHA) Challenges

- MHAs lacked housing development expertise so they had to hire housing consultants, partner with a local housing agency or rely heavily on CalHFA guidance, training and support
- Local housing agencies' housing goals often differed from the MHA goals
- Housing agencies that partnered with MHAs often considered the MHSA funds as gap financing for their own projects – so they focused less on the goals of the MHSA program and sometimes overlooked input provided by the MHAs
- Some private and local housing authority tenant screening processes denied housing to many MHA-referred clients. As a result, MHSA units sat vacant for extended periods of time

Timely Development Challenges

- The higher the density of MHSA clients in a proposed development, the greater the NIMBY obstacles. More time was required to educate and assure the surrounding community that MHSA clients are able to live alone and become effective members of society when provided a comprehensive array of supportive services
- Rural counties had a more difficult time soliciting development proposals from qualified affordable housing developers because there was generally a lack of other available sources of local funding to make the deals financially viable, or competitive in statewide loan or tax credit rounds of funding
- There is a limited number of experienced/qualified housing developers that want to develop permanent supportive housing and adhere to the regulations that control the units
- MHSA-qualified developers are often over extended and understaffed resulting in performance issues.
- Developers spend an average of two years in the pre-development stage to complete:
  - Land acquisition or land lease negotiations
  - Local planning and review process including zoning and conditional use permit approval processes
  - Negotiating Owner Participation or Development and Disposition Agreements with localities providing financing
  - Public meetings to address NIMBY concerns
  - Design changes to address various source of funding design requirements or ADA, Section 504, fair housing , and Article XXXIV issues
  - Site and building inspection reports to evaluate the required scope of rehab or environmental clean-up
  - Multiple competitions for funding through various local, state and federal programs
  - Competition twice a year for a state/federal tax credit allocation
  - Competition for state debt limit allocations for tax-exempt bonds (if applicable)
  - Solicitation of bids from multiple tax credit investors, followed by project specific negotiations with the selected investor

- Renegotiating overlaying occupancy, rent and income limits and reserve requirements with all final sources of funds and tax credit investor.

Property Management Challenges

The parties negotiated MOUs in good faith, thinking they were all on the same page when they originally negotiated their roles and responsibilities. It became apparent, however, that the processes for wait list protocols, screening tenants and the goal to rapidly house mentally-ill clients were not as smooth as expected. Additionally, not all MHSA-eligible residents were approved for SSI/SSP as originally anticipated. Projects needed to have a financial reserve to cover the loss of income for the MHSA units occupied by MHSA clients waiting to be qualified for SSI/SSP, or those that did not qualify for SSI/SSP, and the MHA or property management firm's reluctance to displace.

Additional findings include:

- Some MHA-referred clients did not pass the local housing authority or property management firm's screening process due to prior criminal backgrounds, lack of income or drug and alcohol problems. MHAs had to educate the managing staff, require a new property management firm or in one rare situation, sever a housing authority partnership
- There is greater MHSA unit turnover than originally anticipated
  - Some formerly homeless MHSA clients found the housing rules and responsibilities too restrictive and oppressive
  - MHSA clients that received large back payments of SSI/SSP (because it may take 6-12 months to get qualified for SSI/SSP) often took the money and left the unit, rather than use the funds to pay the back rent they owe
- MHAs needed a source of funds to cover MHSA tenant security and utility deposits and recurring utility bills that some residents did not pay regularly
- With more frequent unit turnovers, MHAs and service providers could not always readily locate MHSA clients who also met overlaying occupancy restrictions (i.e., chronically homeless or veterans who did not qualify for VA benefits); as a result MHSA-regulated units sat vacant longer than anticipated because of slow referrals
- It would have been easier to keep MHSA units filled quickly if regulatory provisions required that the MHAs give a preference to a specific sub-group of MHSA clients (chronically homeless or eligible veterans) as opposed to requiring occupancy by specific sub-groups. However, in a few instances this proved difficult to manage because the developer or management firm chose to ignore approved wait list protocols and house the specific sub-group to the exclusion of other MHA clients on the open wait list
- Units reserved for veterans, or allowing a preference for veterans, took longer to fill, as not all MHSA eligible clients acknowledge that they are also veterans
- Units initially rented and regulated for occupancy by Transitional Aged Youth (TAY) now include provisions to allow the TAY to remain in the unit as an adult
- Projects with high densities of formerly homeless individuals with MHSA eligible residents were developed using multiple funding sources with different rent restrictions. As a result, management firms had a difficult time justifying to any formerly homeless or at risk of being homeless client, why

one pays $50 per month as opposed to the MHSA resident whose unit is subsidized with COSR funds, who pays a minimum of 30% of SSI/SSP

- Some MHAs have had to threaten calling the MHSA loan due and payable, in order to get a borrower or management firm to comply with the terms and conditions of the MHSA Regulatory Agreement or approved MOU
- Some MHAs took longer than anticipated to refer eligible clients to the management firms for screening so units sat vacant longer than the developer would like
- Maintenance of MHSA-occupied units was more costly than anticipated and once an MHSA client moved out, the developer frequently had to replace furnishings that were damaged or stolen
- Bed bug infestations were more likely to occur in MHSA regulated units and the costs to mitigate such issues were not originally budgeted for
- Units developed for shared occupancy by one or more MHA referred client were not as easy to keep filled as originally anticipated because MHAs found that many MHA clients would prefer to live independently or the MHA client wanted to share the bedroom with a partner

Capitalized Operating Subsidy Challenges

- MHSA Term Sheet restrictions on COSR funding levels were often insufficient to meet projected needs during the first 17-20 years of operations so waivers to the COSR limits had to be approved or borrowers had to use other sources of funds to finance the shortfall
- The long term financial viability of each MHSA development requires the recapitalization of COSRs every 15 years, or the renewal of project based subsidies over time, otherwise MHSA residents will once again be homeless as they won't be able to afford the rents that could increase to as high as 30% of 50% of AMI
- Tax credit investors and other permanent lenders wanted assurances the COSR funds were available, so CalHFA agreed to capitalize each MHSA approved COSR at start of construction and hold the funds in project specific accounts
- Some projects submitted annual requests to draw down the COSR at a faster rate than projected for the following reasons:
  - Developers underestimated project operating costs
  - Higher than expected MHSA unit turnover and furnishing replacements
  - COSR tenant rent payment allocations were sized to cover up to 12 months of MHSA rents and proved inadequate to cover rents of MHSA clients waiting to get qualified for SSI/SSP every time there was unit turnover

Meeting the Challenge: The Local Government Special Needs Housing Program

Even though the MHSA Housing Program no longer provides funding commitments, the challenge of developing permanent supportive housing continues. Several larger southern California counties approached CalHFA with a request that we offer another special needs loan program so they could continue to partner with CalHFA and use local and MHSA funds to continue developing housing, or supplement expiring COSR's over time.

Per direction from the CalHFA Board of Directors in May 2015, staff pursued the development of the Local Government Special Needs Housing Program (SNHP). Using the invaluable lessons learned from administering the MHSA Housing Program and considering input from participating MHAs, DHCS, CBHDA and developers, CalHFA has developed the SNHP to be available immediately following the termination of the MHSA Housing Program.

SNHP participation is voluntary and subject to adequate annual funding commitments from participating MHAs. As of May 2016, CalHFA anticipates participation by at least 14 counties that initially intend to assign over $70 million in MHSA funds to CalHFA to administer as the lender on their behalf. The benefits of participation in the SNHP are that local MHAs can continue to solicit and select housing proposals that best meet local needs, while relying on the experience of the state's housing finance agency to ensure MHSA funding is offered to those developments that are likely to remain financially viable over the long term.

Participating MHAs began soliciting supportive housing proposals in the spring of 2016 in anticipation of the SNHP rollout, June 1, 2016. The MHA request for proposals take into account the terms and conditions outlined in CalHFA's SNHP Term Sheet which assumes the MHAs choose the projects that meet local and state goals to create housing that provides the requisite supportive services to benefit the mentally-ill homeless, chronically homeless and those at-risk of homelessness.

CalHFA's role, as the State's affordable housing bank, continues to be a provider of comprehensive housing finance and development training for MHA staff and developers, to underwrite MHA selected proposals to ensure projects are not being over subsidized and to ensure that MHAs are investing MHSA dollars in housing projects that are financially viable over long term.

The SNHP Term Sheet and Participation Agreement can be found on CalHFA's website at [www.calhfa.ca.gov.](http://www.calhfa.ca.gov)

For more MHSA or SNHP information, please contact:
Debra L. Starbuck,
CalHFA Lead MHSA Housing Finance Officer
530.878.8075
dstarbuck@calhfa.ca.gov