

Memorandum

TO: COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: May 8, 2017

Approved

Ken Walsh

Date

May 12, 2017

SUBJECT: AFFORDABLE HOUSING INVESTMENT PLAN (FY 2016/17 - FY 2017/18)

RECOMMENDATION

Accept report and provide comments on the Housing Department's Affordable Housing Investment Plan for expenditure of affordable housing funds covering the current and upcoming fiscal year.

OUTCOME

Acceptance of this report will affirm the Housing Department's overall strategy on the use of housing funds and provide conceptual approval of an overall spending plan that focuses on: 1) developments with permanent supportive housing opportunities for the homeless that leverage Measure A funds; and 2) the development of affordable housing on city owned land.

EXECUTIVE SUMMARY

On November 16, 2015, the Community and Economic Development Committee ("CEDC") approved the Affordable Housing Plan for FY 2015/16 – 2016/17. That document established a blueprint for expending \$103.5 million in funds dedicated to affordable housing. Since the approval of the previous Plan, the Housing Department has enabled the completion of 325 new and newly-affordable apartments in five developments, including 86 for homeless individuals. Since the last Plan, the City Council approved \$46.6 million in funding for an additional seven developments that will offer approximately 526 affordable homes including at least 386 for extremely vulnerable and homeless individuals.

To address the need for housing opportunities for vulnerable populations, the Housing Department issued a NOFA for Permanent Supportive Housing Developments in collaboration with the County and Housing Authority of the County of Santa Clara in July 2016. This "Inter-

agency NOFA” combined City capital financing with services and operations funding from the other agencies.

This proposed Affordable Housing Investment Plan includes two San José developments with new homeless apartments that were eligible for award through the Inter-agency NOFA. Villas on the Park received a City Council commitment in January 2017. Quetzal Gardens is currently working its way through the planning and community outreach process and is slated for City Council consideration in June.

The Proposed Plan for FY 2016/17 – 2017/18 reaffirms the City’s decision to complete homeless housing capital investments already started. It also proposes a strategy of contributing to developments funded by the County’s Measure A funds in order to provide apartments that serve renters with a diversity of incomes and populations.

The scarcity of City funds available for new affordable apartments makes it impossible for the City to fund additional affordable homes in San José beyond the projects identified in this Plan. The County’s Measure A funds are intended to be primarily used to house the most vulnerable populations. Additional public subsidies will be needed to address the demand for housing affordable to lower-income workers who are vital to the Silicon Valley economy. Therefore, the City should support efforts to preserve existing affordable homes, protect its limited financial resources available and seek additional resources at the State and Federal levels.

This Plan also notes key policy issues that are critical to expected residential growth in San José, and are linked to the City’s capital expenditures for new affordable homes. These include the need to update the City’s existing Dispersion Policy, and the need to focus on additional anti-displacement efforts for residents of non-rent stabilized homes.

BACKGROUND

On November 16, 2015, the Community and Economic Development Committee approved the Affordable Housing Investment Plan (FY 2015/16 – FY 2016/17) (“FY 2015-16 Investment Plan”) (<http://www.sanjoseca.gov/index.aspx?NID=1274>). The FY 2015-16 Investment Plan summarized the unmet need for affordable housing, the resources available for affordable housing development, and the various options for utilizing the funds. It established the rationale and framework for using uncommitted funds for homeless housing. Accordingly, it set forth the Department’s strategy to use these funds through FY 2016/17 to increase the stock of permanent supportive housing for the chronically homeless, transitional homeless housing, and to a lesser extent, affordable housing for low-income residents.

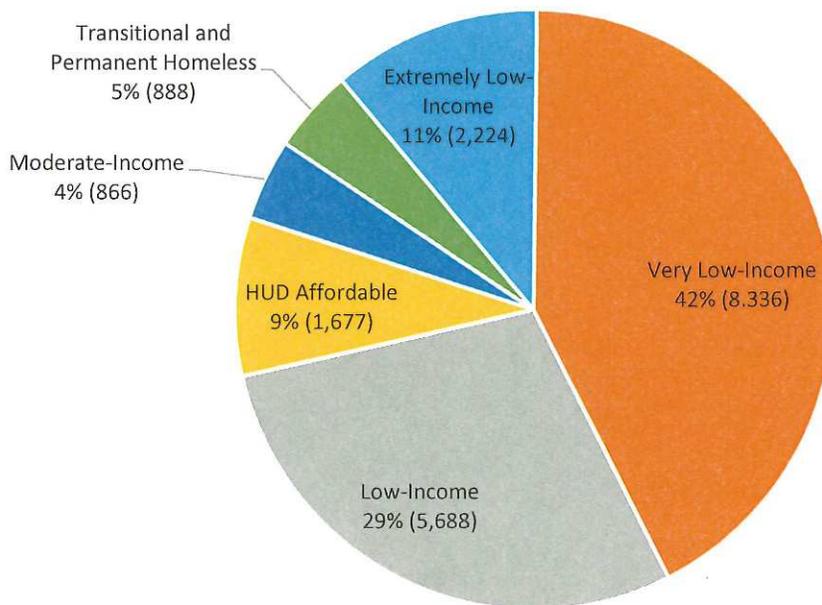
San José’s Past Accomplishments in Affordable Housing

The State and the federal government define housing affordability for each metropolitan area relative to residents’ incomes at various household sizes. Incomes are expressed as a percentage

of area median income (“AMI”). Under State law, Extremely Low-Income (“ELI”) households have incomes up to 30% AMI, Very Low-Income (“VLI”) households have incomes up to 50% AMI, Low-Income (“LI”) households have incomes up to 80% AMI (although City restrictions require the initial income not to exceed 60% of AMI), and Moderate-Income households earn up to 120% AMI (110% for rental projects). For example, the State defined a household of three people as “low-income” in 2016 in Santa Clara County if its residents had a combined gross income between \$50,250 and \$76,400. Generally, maximum rents for each income level (ELI, VLI, LI) are limited to approximately 30% of the maximum income (except LI rents are based on 60% of AMI, not 80% of AMI), including a standard utility allowance. Specific income levels and restricted rent levels for each category of affordability and for each household size are provided in **Attachment A**.

Since the early 1980’s, the City has funded or facilitated the development of approximately 18,000 affordable rental apartments, most of which were subsidized by redevelopment funds. Development loans made by the Housing Department comprise a multifamily loan portfolio currently estimated at over \$670 million. However, as the pie chart below demonstrates, almost three-quarters of the City’s recorded restrictions set rent and income affordability at VLI (42%) and LI (29%) levels. San José’s affordable apartment inventory contains only 2,224 apartments restricted for ELI households. Although 888 apartments are available for the homeless population, only 415 of the apartments are permanent housing with no time limitations.

Income-Restricted Housing in San José, 2017



Despite the City's history of developing 18,000 affordable housing opportunities since 1987, only 6% of the 315,000 total residences in San José (per the 2010 U.S. Census) are affordable deed-restricted apartments. There is a tremendous demand for affordable housing opportunities for residents with a large range of income levels. The need for workforce housing, as well as housing for extremely challenged populations, is well-documented.

Traditionally, the City has funded affordable rental housing for low-income working families, individuals and seniors. Conversely, permanent supportive housing developments targeting homeless individuals received no funding until just recently. This was largely due the fact that permanent supportive housing requires project-based operating subsidies from the public sector. It also requires sustained funding for on-site support services to ensure successful operations. While these resources have been extremely limited in the past, both the County of Santa Clara and the Housing Authority of the County of Santa Clara ("HACSC") have made major funding commitments to incentivize developers to build permanent supportive housing.

This report provides an update on the progress of affordable housing developments stated in the previously adopted plan. It also provides information pertaining to the new developments proposed through the Inter-agency NOFA and other anticipated funding requests. Finally, the report addresses funding challenges and opportunities in the near future, and identifies key policy issues that pertain to the development of new affordable housing.

Current Housing Environment

Prior to presenting a new Investment Plan, it is important to understand the current housing market and housing needs in San José. As was true a year ago, San José continues to experience a housing crisis as rents and home prices remain among the highest in the Country.

Rental Housing Market

San José's rental market continues to be very strong with high rents. The average rent for a two-bedroom, two-bath apartment in the City was \$2,318 for all "classes" of apartments in Q1 2017.¹ Rents have risen 33% over the past five years, far in excess of increases in household incomes during that time.² In 2016, the median income for a household of two in San José was \$85,700 while the annual salary required to afford a two-bedroom/two-bath "market rate" apartment was \$113,040. The first quarter of 2017 apartment vacancy rate is 4.9%, which is under than the healthy rental market benchmark of a 5% vacancy rate.³ This means that the rental market isn't providing sufficient housing and households may have a difficult time finding a home.

¹ Costar Effective Rent and Vacancy Report, Q1 2017.

² Costar Effective Rent and Vacancy Report, Q1 2017.

³ Costar Effective Rent and Vacancy Report, Q1 2017.

Ownership Housing Market

The San José Metro Area was deemed the second most expensive homeownership market in the U.S. in 2016.⁴ Median single family detached home prices in San José rose from \$905,000 in March 2016 to \$980,000 in March 2017—an increase of 8.3%.⁵ Santa Clara County’s sales price rose 11.5% in that period, with a record high sales price of \$1,050,000.⁶ Competition for homes is fierce, as inventory remains very tight and there are multiple offers on home listings. In San José, homes currently are averaging only 22 days on the market and are selling for 4% over asking price.⁷ As interest rates remain close to historic lows but are on an upward trend, near-term demand is expected to stay strong as buyers will try to purchase before rates rise further.

The challenge of saving for large down payments to purchase a home while paying extremely high rents puts extraordinary burdens on potential homebuyers. A 20% down payment on the current median home price of \$980,000 is \$196,000. Assuming a 30-year jumbo fixed-rate mortgage of 4.125%, a 1.25% property tax rate, standard utilities and mortgage insurance, and a moderate credit score, monthly debt service payments would be \$3,800. With a back-end ratio of 30% to 35%, depending on the lender, these payments would require a minimum annual income of \$130,300 to \$152,000. These incomes are, respectively, 34% and 15% higher than the County’s median income for a household of four people of \$113,300.

Condominium prices in San José are, of course, far more reasonable than single family detached homes, with the current median sales price of \$638,000. But, like the single family market, the condominium market is heated, as prices rose 7.9% year-over-year. Homes sold for 3.7% over asking and took an average of only 22 days to sell. Renters would have to save \$136,000 for a 20% down payment on a median-priced condominium. With a 30-year fixed rate mortgage with the same assumptions as above, monthly debt service would be \$2,636 and borrowers’ minimum annual income would need to be \$90,400 to \$105,500. These incomes equate to 100 to 110% AMI, which is the moderate-income category for a household size of three people.

Affordable Housing Need

In San José, almost 20% of households are “severely cost-burdened.” This means they are paying more than 50% of their gross income on housing leaving an insufficient amount of disposable income to pay for their other needs such as food, clothing, medical care and transportation.⁸ In 2016, the San José metropolitan area ranked as the third highest-rent area in the U.S., behind only San Francisco and Oakland.⁹ To afford a one-bedroom apartment in our metro area in 2016, it required 122 hours of minimum wage work per week, or three full-time minimum wage jobs.¹⁰

⁴ National Housing Conference, *Paycheck to Paycheck 2016*.

⁵ Santa Clara County Association of Realtors, March 2017.

⁶ “Bay Area Home Prices Near All-time High,” *The Mercury News*, April 28, 2017.

⁷ Santa Clara County Association of Realtors, March 2017.

⁸ HUD Comprehensive Housing Affordability Strategy (CHAS) for San José City, 2009-2013

⁹ National Housing Conference, *Paycheck to Paycheck 2016*.

¹⁰ National Low Income Housing Coalition, *Out of Reach 2016*.

These very high rents place tremendous pressure on individuals and families to crowd into smaller apartments, to endure longer commutes to less expensive housing markets, and to put up with substandard housing conditions. Some lose their homes altogether. In addition, if the current housing trends continue, the regional economy may suffer if local businesses cannot attract and retain employees.

The State of California, through its Regional Housing Needs Allocation (“RHNA”), has projected that San José will need to build over 3,423 new income restricted homes per year for the next 5.8 years to keep up with population growth.¹¹ These goals are divided by income category, with an annual goal for ELI, VLI, LI, Moderate, and market-rate homes. 2016 marks the third year of the current RHNA production period from January 2014 – October 2022. In order to be on track to meet its goals, the City would need to have produced 34% of its targets in all income categories by the end of 2016. However, San José has been able to meet only 24% of its total RHNA goal thus far. Further, achievements by income category vary significantly. During this three-year period, San José was able to meet 54% of its total market-rate homes production goal but met only 4% of its affordable housing goal. No new moderate-income housing opportunities were made available during this time.

Homeless Housing Need

The demand for all types of affordable housing creates an extremely challenging situation for the most vulnerable, unhoused members of the community. More than 4,000 people in San José are homeless, with over two-thirds of that population living on the streets or in encampments. While some of these residents can resolve their own homelessness through limited or one-time assistance, over 1,400 people are chronically homeless and require permanent housing with supportive services to fully stabilize. The average life expectancy for individuals experiencing homelessness is 25 years less than those in stable housing. Lack of adequate shelter also exposes unsheltered individuals to victimization and inclement weather.

A portion of San José’s homeless population is chronically homeless and may suffer from substance abuse or have mental or physical disabilities that prevent them from ever becoming economically self-sufficient. Therefore, ongoing rental housing subsidies will always be needed to help these most vulnerable people. Permanent supportive housing solutions for chronically homeless residents require project-based rental subsidies as well as on-site social and health services. Costs for services are typically provided through County funds. Thus, sustainable funding of permanent supportive housing requires a collaboration between cities, counties, and housing authorities in order to be feasible.

¹¹ San José Housing Element Report, December 2016.

ANALYSIS

Prior to the creation of the FY 2015-16 / FY 2016/17 Affordable Housing Investment Plan, the Department had received substantial loan prepayments from its existing portfolio of multifamily loans. As a result, the Department developed a proposed \$103.5 million Investment Plan that contained a list of developments that would utilize all uncommitted funds. These projects are listed in **Attachment B**. This list included previously-funded projects for which City Council commitment requests were in progress and funding commitments anticipated through FY 2016/17. The Department's progress toward completing developments in the adopted Investment Plan is summarized below.

Completed Developments: Five developments that the City funded with a total of \$37.4 million were completed during this period. These developments created 325 new or newly-affordable homes, including 86 for homeless residents. The developments are Creekview Inn, Donner Lofts, Japantown Seniors, Metropolitan North, and Santa Clara Inn.

Developments with Funding Committed and/or Under Construction: Seven developments identified in the previous Investment Plan obtained \$46.6 million in City funding commitments and made significant progress during this period. In total, 526 new and newly-affordable homes are being created in these developments, including 386 homes for homeless residents. The seven developments are listed below.

- The HIP Developments, the Plaza, and the Vermont House are currently undergoing rehabilitation.
- The Metropolitan South and Second Street Studios have obtained all their needed financing and started construction.
- North San Pedro and Downtown Supportive Housing (aka Villas on the Park) have purchased their sites and anticipate starting construction in the second half of 2017.

Developments with Funding Commitments in Progress: Six developments identified in the previous Investment Plan are in the process of obtaining funding commitments from the City and other funders. These developments will be discussed later in this memo as part of the projects to be included in the proposed FY 2016/17 – FY 2017/18 Investment Plan.

Inter-agency Notice of Funding Availability

The Adopted FY 2015-16 / FY 2016/17 Investment Plan articulated the need to align project-based rental vouchers ("PBVs") with new supportive housing developments. It also acknowledged a time-limited opportunity to partner with HACSC and Santa Clara County's Office of Supportive Housing. The alignment of spending priorities for the City, the County, and HACSC ("Agencies") prompted the release of Notice of Funding Availability ("Inter-agency NOFA") in July 2016. The Inter-agency NOFA's focus was to provide resources to create new permanent supportive homes for the homeless and for other vulnerable populations.

HACSC made available up to 603 new PBVs through the Inter-agency NOFA. The County agreed to provide up to \$8 million in capital funds and “wrap-around” support service commitments for the new supportive housing apartments receiving PBVs. The City budgeted \$25 million in capital funding. This was the first time that the three Agencies collaborated to create a one-stop funding vehicle. The types of developments eligible for the City’s funds were those creating affordable homes for chronically homeless households, for non-chronically homeless households, and/or incorporating ongoing referral rights for formerly-homeless residents possessing rental subsidies.

The Inter-agency NOFA deemed as eligible for award two San José developments that will create new affordable housing for homeless residents. The Villas On the Park and Quetzal Gardens projects will be discussed later in this memorandum in the discussion of projects to be included in the Proposed Investment Plan.

Summary of Progress in Implementing the Adopted FY 2015/16 – FY 2016/17 Investment Plan

In summary, since the last Investment Plan, staff has worked diligently to facilitate the creation of 851 affordable apartments which have either been completed, funded or are under construction. In addition, of which 472 are for homeless households. In addition, significant progress has been toward the commitment of funds for at least 345 new affordable apartments that are included in the proposed funding plan.

City Funding Sources for Affordable Housing

The Adopted FY 2015-16 / FY 2016/17 Investment Plan discussed the various sources of revenue the City has to fund affordable housing developments. This section of the Plan restates those sources and provides updates as to the current availability of funds.

Low and Moderate Income Housing Asset Fund

Redevelopment funding set aside for affordable housing was the major source of the City’s financial resources until redevelopment’s dissolution in 2011. Since that time, annual loan repayments and full loan repayments of the City’s redevelopment-funded loans are deposited into the Low and Moderate Income Housing Asset Fund (“LMIHAF”). Although redevelopment agencies have been eliminated, State law continues to require that repayments of loans funded by redevelopment funds be used to create, rehabilitate, or preserve affordable housing.

Unlike private lenders which generate income through receipt of set payments of principal and interest on outstanding loan balances, the City receives loan repayments from a share of properties’ “residual receipts.” Residual receipts are funds in excess of those needed to pay properties’ operating expenses. While critical to the City’s ability to operate and invest in new affordable apartments, the City’s receipt of loan repayments is secondary to the social purpose of providing affordable, well-maintained properties that benefit the public. In fact, many cities receive minimal interest or residual receipt payments on their affordable housing loans.

Homeless or deeply-affordable developments typically do not provide any annual repayments. San José, by comparison, has a relatively robust portfolio that provides a predictable stream of revenue that is used to help manage its portfolio of affordable apartments.

Funding Available for New Affordable Housing Developments:

The current balance of LMIHAF available to reinvest in new affordable developments is approximately \$8.8 million. At this time, the Department is not aware of any pending major loan payoffs. Therefore, staff is programming approximately \$8.8 million in LMIHAF resources for this purpose.

Inclusionary Housing In-Lieu Fees

The Citywide Inclusionary Housing Ordinance (“Ordinance”) requires that, in market-rate for-sale new developments of 20 or more homes, 15% of the homes be made affordable to and sold to moderate-income households. The Ordinance provides several alternative ways that the developer can meet its requirement, including payment of an in-lieu fee and construction of affordable homes off-site. Implementation of the Citywide Inclusionary Housing Ordinance restarted in 2016 after the City successfully defended a legal challenge to the Ordinance from the California Building Industry Association.

The Ordinance’s predecessor for new developments in redevelopment project areas was the City’s Inclusionary Policy (“Policy”). The Policy has a requirement that 20% of newly-constructed for-sale homes be made affordable to and sold to moderate-income households. Like the Ordinance, the Policy allows payment of in-lieu fee revenue as an option to building the required affordable homes. Both the Policy and redevelopment project areas survived dissolution of the redevelopment agencies. Due to the 2009 *Palmer* court ruling in Los Angeles, the Ordinance and the Policy pertain only to for-sale developments.

The Ordinance is now in effect for most locations in the City for developments receiving planning permits on or after July 1, 2016. The Policy remains in effect for for-sale developments in redevelopment project areas that obtained all permits prior to that date.

Eligible uses for Inclusionary in-lieu fees include capital costs for restricted affordable housing developments for ELI, VLI, LI, and moderate-income households.

Funding Available for New Affordable Housing Developments:

Inclusionary programs have generated relatively few In-lieu Fee revenues or moderate-income homes in the past few years. The Housing Department started this fiscal year with a balance of \$2.4 million and expects to receive \$3.2 million in fee revenue by the end of FY 2016/17. At present, no In-lieu revenue is anticipated for FY 2017/18. Therefore, the amount available for developments is \$5.6 million.

Affordable Housing Impact Fee

On November 18, 2014, the City Council adopted the Affordable Housing Impact Fee (“AHIF”) Resolution establishing the AHIF program. Under AHIF, new market-rate rental housing developments are charged a fee based on net rentable square footage to address the impact that type of development has on the need for affordable worker housing. Revenues must be used to fund development of homes for lower- and moderate-income workers, per a prescribed methodology for varying levels of affordability. Revenues must be used to fund development of homes for ELI, VLI, LI and moderate-income workers, per a prescribed methodology for varying levels of affordability. The methodology reflects the AHIF Nexus Study’s analysis of market-rate developments’ impacts.

The AHIF was approved with an exemption program (“Pipeline Exemption”) for projects with approvals issued before June 30, 2016 that are completed before January 31, 2020. The AHIF also has a limited-time exemption for Downtown High-Rise rental developments that meet the program’s definition, record an Agreement on-site before the issuance of a building permit, and receive a certificate of occupancy by June 30, 2021.

Funding Available for New Affordable Housing Developments:

Due to the two exemptions noted above, the Housing Department expects no AHIF revenues prior to the end of FY 2016/17. Revenue of \$1.5 million is expected in FY 2017/18.

Federal Funds for Affordable Housing – CDBG and HOME

The City receives approximately \$2.4 million in HOME funds by formula from the U.S. Department of Housing and Urban Development (“HUD”) on an annual basis. These funds must be used to provide housing for low-income households. Approximately \$1.3 million in HOME funds is programmed for Tenant Based Rental Assistance (rent subsidies) annually for homeless individuals and families. The remaining level of annual revenue is insufficient to effectively subsidize an affordable housing development. Therefore, the City collects several years of HOME allocations and repayment of HOME-funded loans to make one development commitment.

The City receives approximately \$8.4 million in federal Community Development Block Grant (“CDBG”) funds annually. Typically, around 40% of the CDBG funds are used for capital projects. Recent capital projects include homeless facility rehabilitation, community center improvements, street lighting, library improvements, and pedestrian and traffic safety projects. To support affordable housing developments, CDBG can be used to fund associated infrastructure work or acquire land; however, it cannot be used for development of the residences themselves.

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Funding Available for New Affordable Housing Developments:

In FY 2017/18, the Department anticipates having \$6.7 million in HOME funds available for new affordable development financing. This consists of \$1.5 million in the City's new annual allocation and \$5.2 million in loan repayments. Due to other funding commitments, no CDBG funds are available for affordable housing land acquisition or infrastructure in FY 2017/18.

It should be noted that President Trump's proposed budget for FY 2018/19 calls for the complete elimination of new funding for CDBG and HOME Programs. While the federal government will continue to operate via Continuing Resolutions through FY 2017/18, the FY 2018/19 budget remains uncertain. Loss of CDBG and HOME would be devastating to the City, as these funds provide almost \$11 million annually to support affordable housing and other vital programs for lower-income populations. Any major reduction in funds would not go into effect until FY 2018/19.

Homeless – General Fund

As directed by the Mayor and City Council, unexpended 2016/17 funds from the Rapid Rehousing appropriation for design and implementation of the Transitional Communities (AB2176) project have been rebudgeted.

Funding Available for New Affordable Housing Developments:

\$2.3 Million is available from the General Fund.

HUD Litigation Award

The City of San José's Housing Authority ("CSJHA") is a public entity formed under State Housing Authority law. Housing authorities typically receive rental vouchers, administrative funds, and other resources from HUD. However, CSJHA has an agreement with the Housing Authority of the County of Santa Clara's ("HACSC") under which the CSJHA authorizes HACSC to administer the CSJHA's rental voucher and other HUD programs on its behalf. The agreement requires HACSC to consult the CSJHA Board on policy and strategic decisions. The Board of CSJHA is the City Council, and its Executive Director is the Director of Housing.

On behalf of the CSJHA, HACSC filed suit against HUD in the U.S. Court of Federal Claims for breach of contract by HUD resulting in underpayment of funds. The suit was successful, and CSJHA received \$36.3 million in a litigation award in 2016 ("HUD Litigation Award Funds"). CSJHA may use these litigation award funds for purposes authorized under Housing Authority law for affordable housing purposes related to "housing projects" as defined under State law. Since CSJHA has no staff, the CSJHA would need to enter into a cooperation agreement under which the City is permitted to administer the funds for the CSJHA. The City Attorney's Office currently is working with the Housing Department to finalize the Funds' permitted uses. It is

anticipated that the Housing Department and the City Attorney will bring the cooperation agreement to the City Council for approval in early fall 2017.

Funding Available for New Affordable Housing Developments:

Approximately \$23.3 million of the total HUD Litigation Award is available for development of new affordable housing.

County Measure A Funding

Voters of County of Santa Clara County approved the landmark Measure A in November 2016 to support new affordable housing. The Measure authorized the County to issue \$950 million in general obligation bonds to be repaid by a new parcel tax for affordable housing. The bonds are expected to be issued in two tranches over a 10-year period. Measure A funds will be used to acquire or improve real property to provide service-enriched affordable housing for vulnerable residents. The target populations include veterans, seniors, the disabled, victims of abuse, the homeless, and individuals suffering from mental health or substance abuse illnesses. Most of these households will be ELI, while others may be VLI or LI. Of the total bond, up to \$150 million may be spent for moderate-income families, including a maximum of \$50 million for first-time homebuyer programs. The County plans to issue its first NOFA this Summer and to request Board of Supervisor approvals of new development funding commitments this Fall.

Funding Available for New Affordable Housing Developments:

Measure A funds are County funds to be administered by County staff. The County will seek feedback from cities on proposed developments, but each jurisdiction has a limited role on final decisions as to where the funds will be spent. Most of the County's funds are earmarked to create new affordable housing for ELI households. Unless it also agrees to contribute funding, the City will have a limited role in determining the population served by developments funded by Measure A.

It is important to note, however, the City remains in control of land use entitlement approvals. The Housing Department and Department of Planning, Building and Code Enforcement ("PBCE") together will be actively involved in the siting and approval of these projects. PBCE approves land use entitlements, and both Departments coordinate on CEQA and NEPA approvals analysis.

Total Funding Available for New Affordable Housing Developments:

The table below summarizes the sources listed in this memorandum. In total, there is \$48.2 million anticipated to be available for affordable housing developments through FY 2017/18.

Funding Available for Developments through FY 2017/18 (in millions)

LMIHAF	Incl. In-Lieu	AHIF	HOME	General Fund	HUD Litigation	Total
\$ 8.8	\$ 5.6	\$ 1.5	\$ 6.7	\$ 2.3	\$ 23.3	\$ 48.2

Policy Alternatives Regarding the Allocation of Available Resources

Given the limited amount of City funding available to meet its affordable housing needs, the City must make decisions on how it will allocate its resources. In general, market conditions since the approval of the Adopted FY 2015/16 – FY 2016/17 Investment Plan, have not changed. However, there several new factors that should be considered in determining the type of development to fund in the near future.

Housing for the Homeless and Mixed-Income Multifamily Affordable

The City Council’s focus on meeting the needs of homeless residents matches the strong political will from other agencies and the public to focus limited resources on this population. The passage of the County’s Measure A demonstrates that more than two-thirds of the County’s residents are willing to tax themselves so that the County can better serve vulnerable populations. Most of the County’s Measure A funds is expected to support homeless housing developments, both for chronic and non-chronic homeless. There is no need for the City to duplicate the County’s efforts. However, there is a need to fund VLI and LI households that Measure A cannot fund. If the City were to contribute to Measure A-funded developments, it could create mixed-population, mixed-income deals funded by both the City and the County.

Alternatively, if the City does not invest in Measure A developments, then it is likely the developments will be 100% supportive housing or 100% ELI housing. While there is a need for these developments, there is also a demand for housing that provides a range of affordability. Having a greater range of apartment rents increases developments’ ability to support commercial mortgages which therefore lowers the subsidy funding needed per apartment. The rental income also helps support proper maintenance and upkeep of the developments. Therefore, to help create a range of new affordable homes, the Housing Department will work in collaboration with the County to pursue opportunities that leverage City resources with Measure A funds.

Moderate-Income Housing

San José’s RHNA goals include a production goal of 6,188 moderate-income homes over a nine-year period, equating to 703 such homes per year. Unfortunately, the last Housing Element update cited that no homes for moderate-income residents had been produced during the last reporting period. There are different options the City could pursue to facilitate the development of moderate income housing.

Moderate-Income Rental Programs

In the 1990's and early 2000's, it was possible for housing developers to provide moderately-priced rental housing with little or no public subsidy. In the current market, public subsidies would be needed. Most of the City's funding sources can only serve low-income renters up to 60% AMI. As a result, the City could not leverage these funds with federal and State tax credit subsidies. As mentioned previously in this memorandum, there is \$11.6 million in Inclusionary In-lieu fees that could be used to help fund a rental development targeted to moderate income residents. The City Council could direct that these funds be directed for this purpose. If the City were to fund moderate-income rental developments, it would be almost twice as expensive per home as it would be to subsidize low-income rental housing developments funded with tax credits.

Moderate-Income Homeownership Programs

In the past, for-sale housing for moderate-income workers was built in San José without significant public subsidies. Homes built under the Inclusionary Housing Policy were discounted to moderate-income buyers by the developer. When for-sale market prices were lower, that developer discount was often sufficient to allow the buyer to purchase the home without any additional subsidy.

The City used to provide homebuyer loans to moderate-income buyers through its redevelopment funds. However, loan repayments from loans funded by redevelopment funds is no longer allowed under State law. When the City did provide homebuyer loans, total subsidies per homebuyer ranged from \$50,000 to \$100,000 as different homebuyer loan types could be layered. In the current market, staff estimates that subsidies of \$100,000 to \$150,000 per household on average would be required to supplement moderate-income buyers' commercial mortgages.

These subsidies for homebuyers result only in a short period of affordability under the City's homebuyer program model. The City's programs historically have allowed borrowers to resell their homes to any buyer, as long as a share of the equity gained in the home was shared with the City upon resale (the "equity-share model"). Once the home is sold and funds are paid to the City, the home loses its income restrictions. This is in stark contrast to City-subsidized rental properties, which are restricted for 55 years.

Other Options for Providing Moderate-Income Housing

In addition to the options mentioned above, there are other alternatives to serve moderate-income housing needs that staff could pursue. One alternative is to explore the creation of a community land trust that would hold homes acquired under a down payment program as affordable into perpetuity. To be successful, there is a certain number of homes needed to start a land trust model. Staff could study the model and propose a strategy to develop a land trust in San José.

Another alternative would be for staff to explore developing for-sale homes on one of the City-owned sites. It is important to note that for-sale development is much riskier financially than is rental development because developers have one chance, at the time of sale, to recoup their investments. In the past, the City funded land acquisition and/or construction for a handful of for-sale developments. These were not successful due in part to market timing and the difference in housing prices from the time the development was funded to the time homes were sold. The City's investments had to be complemented by funding of homebuyer loans in addition to subsidizing the developments' construction.

The City is not the only option for low- and moderate-income homebuyers seeking subsidies to purchase homes in our expensive housing market. The Silicon Valley Housing Trust, funded by public and private funds, runs homebuyer programs for several local jurisdictions. In addition, up to \$150 million of the County's Measure A funds can be used for moderate-income housing programs, including up to \$50 million that could be used for homeownership programs. The County's current proposal for the first portion of Measure A funding has a set-aside for \$25 million for down payment assistance programs.

Given the demand for affordable housing to benefit working families, and the high cost of producing moderate-income housing, staff will continue to facilitate the development of low-income rental housing. Staff is in the process of developing a moderate-income housing strategy. The strategy will look at potential public funding options as well as legislative actions that could be implemented to address this need. Staff also will reexamine whether the State will permit some unrestricted, previously uncounted homes to be counted towards our RHNA goals.

Summary of Proposed Investment Strategy

In summary, the Department's proposed funding priority will be to complete commitments already started for permanent supportive housing for homeless households. Once additional funds are identified, the Department will seek funding opportunities to contribute to County Measure A-funded developments for the purpose of providing apartments which would serve the very low- and low-income general working population. This will enable Measure A developments to house residents with a range of incomes and populations. The Department will also develop strategies to serve moderate-income households through policy development and implementation.

Proposed Affordable Housing Investment Plan

Consistent with the summary of the investment strategy, the Housing Department has developed an Affordable Housing Investment Plan for FY 2016/17 – 2017/18. The following developments are included in the Plan. These are projects for which staff will request new funding commitments by the end of FY 2017/18. The first two projects were selected to be funded through the Interagency NOFA for Permanent Supportive Housing for the Homeless.

- Villas On the Park: Previously referred to as the Downtown Supportive Housing project, the Villas is located at 278 North Second Street. It will offer 78 permanent supportive apartments for chronically homeless residents. It will also provide 15 interim beds for non-chronically homeless individuals. The City Council approved a commitment of \$16.6 million to Villas on the Park in January 2017.
- Quetzal Gardens: This new development selected through the City's Inter-agency NOFA will offer 20 apartments for chronically homeless households as well as 50 large family apartments that are much-needed in the Little Portugal neighborhood. It will also offer 11,600 square feet of commercial space. In June, the development's land use entitlements are scheduled for hearing by the Director of Planning Building and Code Enforcement. The Housing Department plans to bring a request for subsidy commitment of up to approximately \$9 million to the City Council in June 2017.
- Leigh Avenue Seniors: Leigh Avenue Seniors will be a new construction mixed-use development offering 63 affordable apartments, including 20 apartments for homeless seniors, along with 7,000 square feet of dental offices. Leigh Avenue originally applied to the City for funding in 2009, before the economic downturn and dissolution of redevelopment; therefore, its eligibility preceded the recent Inter-agency NOFA.
- Evans Lane: The City Council awarded control of this City-owned site and predevelopment funds in August 2016. Abode Communities, the selected developer, is currently in the land use entitlements process. The current plan is for this site to be developed with prefabricated shared housing to provide interim homes for the homeless. The site was purchased with redevelopment funds. These funds have a requirement that the development must begin within a specified time after purchase. Affordable housing development must commence on this site in the next 1.5 years.
- Transitional Community developments under AB 2176: These "bridge communities" for the homeless will be located throughout the City. The sites to be leased at no cost are in various stages of availability, and it will take an estimated \$3.5 million to cover closing costs, site preparation and improvements.
- 226 Balbach: The Department purchased the Balbach site from the Successor Agency to the Redevelopment Agency ("SARA") in August 2016. Staff plans to request an award of site control and predevelopment funds to the City Council in June 2017 to a developer selected through a competitive process. After the developer obtains land use entitlements and a community process has been completed, staff will return to the City Council to with a request to approve construction/permanent financing. At this time, almost 30% of the site's planned apartments are expected to serve residents at-risk of homelessness.
- Mesa/Gallup: The Department purchased the Mesa/Gallup site from SARA in May 2016. Staff plans to request an award of site control and predevelopment funds to the City Council in June 2017 to a developer selected through a competitive process. After the developer

obtains land use entitlements and a community process has been done, staff expects return to the City Council to request construction/permanent financing. Over 40% of the apartments on this site are expected to serve residents at-risk of homelessness, such as youth existing the foster care system.

- **City-owned Sites:** The Department is considering the construction/permanent commitments for both Site #1 and Site #2 as soon as funds are available. Staff is estimating that each to-be-purchased site would need approximately \$10 million for construction of affordable homes. Funding for the acquisition of these sites is stated listed in FY 2017/18 while construction financing would occur in the following year.

Each of these developments require land use entitlement and City Council funding approval. Extensive community outreach will be completed as part of the approval process for each project. While these new opportunities will make a significant contribution toward addressing the housing needs of hundreds of extremely vulnerable individuals, there is still a tremendous need for affordable housing in San José.

Need to Preserve and Expand Resources for New Affordable Housing

It is critical that the Department have enough resources for affordable housing creation so that City funds may leverage other resources. As discussed above, the City's funds will be contributed to Measure A-funded projects to create mixed-income developments. For the City to be awarded State Cap and Trade funds and to control the trails and walkability improvements from the Affordable Housing and Sustainable Communities program, the City's funds must create deeply affordable homes. For the City to issue tax-exempt bonds and to receive vitally-needed annual monitoring fees ongoing, it needs to invest funds into local developments.

While Affordable Housing Investment Fee revenues are expected to start generating revenue for affordable housing in FY 2018-19, potential changes in economic conditions could further delay the receipt of funds for new development. Therefore, it is imperative that the City continue to work to preserve and expand the State and federal governments' production programs as much as possible. These include HOME, CDBG, low-income housing tax credits, the National Housing Trust Fund, and new potential tax credit programs to benefit workforce housing. The City has voiced its support for the State Assembly's *Palmer* overturn bill that would restore rental provisions to the City's Inclusionary Ordinance. The City also continues to take opportunities to affect State legislation on subjects such as By-right Development. Finally, the City will be working cooperatively with the County to implement Measure A as efficiently and as appropriately as possible in order to support affordable developments in San José.

Policies Critical to Implementation of the Affordable Housing Investment Plan

This Investment Plan also notes two key City policy issues that are critical to the creation of and preservation of affordable housing in San José. These include the City's Dispersion Policy and the need for a range of Anti-Displacement strategies.

Dispersion Policy

The Housing Department and PBCE administer the City's Dispersion Policy. This policy addresses the location or "siting" of affordable housing throughout the City. The existing Dispersion Policy was adopted by City Council in 1988 and was amended in 1995. It encourages City-funded affordable housing to be constructed throughout San José to achieve socio-economic integration at the neighborhood level. It discourages concentration of low-income households by defining a development's location in 'impacted' census tracts as one criterion to consider in evaluating City approvals. An impacted census tract is one in which more than 50% of households are low-income. In this case, low-income is defined as having incomes at or below 80% of area median income.

Even in impacted census tracts, however, other mitigating conditions may provide support for affordable developments to proceed. Such conditions may include siting near major transit or forthcoming developments of market-rate residential or significant job-producing commercial space. Administration of the Dispersion Policy will help determine the locations in which the City is comfortable approving Measure A-funded developments.

There have been significant changes in the housing market since the Dispersion Policy was last amended in 1995. In addition, the City has created Urban Villages through its General Plan 2040, which will focus residential growth near transit to create transit-oriented, mixed-use communities that are walkable. Given the recent General Plan amendments, 100% affordable developments also may now advance ahead of Urban Village horizon constraints.

For these reasons, staff is creating a workplan to update the Dispersion Policy. The updated Policy will likely focus how the City can best integrate housing affordable at a range of incomes throughout the City in a way that is balanced with commercial uses, especially in the context of Urban Village development. The Housing Department plans to bring proposed revisions to the Dispersion Policy to City Council committees and to the entire City Council in FY 2017/18.

Anti-Displacement Policy

Staff has initiated research to identify possible anti-displacement strategies for residents in areas of forthcoming development. Areas near developing transit stations are potentially vulnerable to displacement. Such strategies and policies may also affect how the Department works with affordable housing developers, and with both market-rate and rent controlled properties. The need for a broad strategy is part of the work required by the Housing Element workplan for General Plan 2040. It also intersects with guidance on affirmatively furthering fair housing.

EVALUATION AND FOLLOW-UP

The Housing Department will bring forward the new developments cited in this report to City Council on an individual basis when they are ready for funding commitments and appropriation

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approvals. Each memorandum will cite progress and cross-reference the recommended action to this Funding Plan. In addition, staff anticipates bringing updates to policies and legislative support items that are noted above in the coming year.

PUBLIC OUTREACH

The Affordable Housing Investment Plan will be posted on the City's website for the Community and Economic Development Committee Agenda for May 22, 2017.

COORDINATION

This memorandum has been coordinated with the City Manager's Budget Office and the City Attorney's Office.

COMMISSION RECOMMENDATION

This item was not heard by the Housing and Community Development Commission, as approvals of affordable development financing do not fall under the functions, powers and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

FISCAL/POLICY ALIGNMENT

This Plan is consistent with: the City's *Envision 2040 General Plan*, *The 2014-23 Adopted Housing Element* in that it will help the City meet its Regional Housing Needs Allocation; the City's *Adopted FY 2015/16 – FY 2016/7 Housing Investment Plan* in that it increases the supply of affordable housing; the City's *2015-20 HUD Consolidated Plan* in that it will provide apartments that will be affordable for very low- and extremely low-income households; and, the *Community Plan to End Homelessness* approved by the City Council in February 2015 in that it is providing supportive housing for homeless residents.

COST SUMMARY/IMPLICATIONS

This memorandum does not commit the City to any specific expenditures. As proposed developments obtain land use entitlements and become ready for funding commitments from the City, they will be brought forward to the City Council for approval and appropriation action on an individual basis.

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CEQA

Not a Project, File No. PP10-069 (a), Staff Report.

/s/

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Director, Housing Department

For questions, please contact Dave Bopf, Deputy Director, at (408) 535-3854.

Attachments