



Memorandum

TO: COMMUNITY & ECONOMIC DEVELOPMENT COMMITTEE
FROM: Jacky Morales-Ferrand
SUBJECT: SEE BELOW
DATE: March 11, 2019

Approved /s/
Kim Walesh

Date 3/15/19

SUBJECT: AFFORDABLE HOUSING INVESTMENT PLAN UPDATE

RECOMMENDATION

1. Accept the staff report on the update of the Housing Investment Plan for expenditure of affordable housing funds;
2. Include two new priorities funding acquisition and/or rehabilitation of existing market rate housing and a minimum of 30% of funds be invested in extremely low-income housing over the life of the Housing Investment Plan and;
3. Cross-reference this report to the full City Council to be heard at the April 9, 2019 City Council meeting.

EXECUTIVE SUMMARY

This report serves as an update to the City of San José's Affordable Housing Investment Plan ("Investment Plan") summarizing the Housing Department's strategy to meet the demand for affordable housing given current funding. It quantifies the available funding for affordable housing and estimates the number of new affordable homes that can be built through FY 2022/23, consistent with the [Housing Crisis Workplan](#). The City Council approved priorities for funding are listed below:

- Projects ready for immediate construction (project readiness);
- The provision of supportive housing for homeless individuals and families;
- Project cost effectiveness (keeping project costs as low as possible);
- The leverage of Affordable Housing and Sustainable Communities funding; and
- Developments proposed on City-owned sites.

The update to the Investment Plan recommends including two new priorities for future funds. First, a new priority for acquisition and/or rehabilitation of existing market-rate housing will be established by creating a set-aside of \$10 million in funding for this type of development. In these cases, a developer will propose the purchase of an existing market-rate rental development and an affordability restriction associated with the funding will be placed on the property, creating new affordable housing. Due to concerns regarding rising costs and potential displacement of existing residents, allowing for a small investment in acquisition rehabilitation developments will open the door to creative solutions while minimizing cost and displacement. This type of development will increase the number of affordable units (10,000) but may will not increase the overall number of new housing units (25,000).

The second priority is to require a minimum of 30% of all new funding to be dedicated to extremely low-income households. This priority is consistent with requirements by state law to spend 30% of funding on extremely low-income households and the continued need for housing in this income category.

The update to the Investment Plan estimates that 1,412 new affordable housing units will be added to the 1,146 currently in the managed pipeline and 946 units currently funded or under construction for a total of 3,503 new affordable units that will be created, under construction or funded by the end of FY 2022/23.

The total to be funded and built from both City investment and efforts outside of the City is 5,771 units. There is a significant shortfall in meeting the affordable housing production goal established by the Mayor and City Council. Over \$520 million in funding is necessary to fund the gap of 4,229 units to meet the goal of providing 10,000 affordable units. New funding sources for affordable housing, including creative strategies, must be explored to meet the City's affordable housing goals.

BACKGROUND

The Investment Plan is a guiding document that defines how the Housing Department intends to invest funding for the development of affordable housing during a designated time period. Over the past few years, the plan has served as guiding document for determining the types of affordable housing and amounts of funding available for investment. **Table 1** lists these reports and other related reports approved by the Community and Economic Development Committee (CEDC) and/or City Council.

Table 1: Summary of Reports Approved by the CEDC

Date	Report	Summary
November 16, 2015 (CEDC)	FY 2015/16 – FY 2016/17 Investment Plan	Investment in permanent supportive housing in coordination with the County and Housing Authority
December 8, 2015 (City Council)		
May 22, 2017 (CEDC)	FY 2016/17 – FY 2017/18 Investment Plan	Investment in permanent supportive housing and on City-owned land
June 13, 2017 (City Council)		
September 28, 2017	Mayor’s Memo entitled <i>Responding to the Housing Crisis</i>	15-point strategy leading to the development of 25,000 homes in five years, of which 10,000 would be affordable
April 23, 2018 (CEDC)	FY 2017/18 - FY 2021/22 Affordable Housing Investment Plan	Investment Plan identified challenges in meeting the Mayor’s goal of creating 10,000 affordable homes and addressed potential funding strategies to address the projected shortfall of 4,385 homes
June 12, 2018 (City Council)		
June 12, 2018 (City Council)	Housing Crisis Workplan	Discussed possible means to increase housing production that were identified in both the Mayor’s memo and the Investment Plan
February 25, 2019 (CEDC)	Housing Crisis Workplan Update	Provided an update on the status of implementing the action items identified in the Housing Crisis Workplan
March 19, 2018 (City Council)		

New Affordable Housing Developments Placed in the Managed Pipeline

In an effort to implement the most recent adopted Investment Plan, the Housing Department issued a \$100 million Notice of Funding Availability (NOFA) in August 2018. The NOFA provided a mechanism for housing developers to submit written proposals for affordable, multifamily, rental housing projects for extremely low-, very low-, and low-income individuals and families. The NOFA introduced the concept of a “managed pipeline.” The pipeline consists of developments demonstrating readiness for funding that have been placed in the highest priority for funding. If development timelines are not met, funding is shifted to the next “ready” development, thereby moving the other project further down in the managed pipeline. This allows the City’s investment to be made in developments ready to secure financing and begin construction.

Thirteen new affordable housing developments were submitted in response to the NOFA, exceeding the \$100 million by \$19 million. Eleven affordable housing developments were selected through the NOFA process and were placed in the managed pipeline. The other two projects submitted in response to the NOFA were placed on a wait list to enter the managed pipeline. As the City identifies additional funds, the two developments on the waitlist may be

moved into the managed pipeline and excess funds will be made available through a subsequent NOFA. The eleven developments will result in 1,144 new, affordable housing apartments in San José, including 297 supportive housing apartments. Supportive housing includes two types of housing for formerly homeless families and individuals combined with supportive services – permanent supportive housing and rapid rehousing.

Current Pipeline Brings the City to 20% of the 10,000-unit Goal

The Mayor and City Council established a goal of building at least 10,000 new affordable units in San José by 2023. At the close of year 2018 (year one), there were 946 apartments completed, under construction or in predevelopment. As the NOFA developments are approved by the City Council for funding, the number of apartments in predevelopment will increase. If all the projects are successful, a total of 2,090 units will be in some phase of development bringing the City over 20% of the way toward the 10,000-unit goal.

ANALYSIS

This document serves as an update to the Affordable Housing Investment Plan (Investment Plan). The document provides an update on progress made toward adding 10,000 affordable housing opportunities and measures the gap to reaching the goal. It also provides updates on funding strategies to meet the 10,000-unit goal.

Exploring New Funding Sources for Affordable Housing

One strategy identified in the Investment Plan was to support legislation creating new funding sources for affordable housing. Changes in State law or local measures were strategies put in place to identify the sources of funding necessary to meet the 10,000-unit goal. An update on these items is provided below.

New Statewide Document Recording Fee (SB 2)

Senate Bill 2 (Atkins, 2017) provides a permanent source of funding for affordable housing by imposing a \$75 document recording fee on certain real estate transactions up to a maximum of \$225 per transaction per parcel. SB 2 is estimated to generate \$250 million annually, statewide. San José will be an entitlement jurisdiction under the program and will receive funds non-competitively, as long as it has an approved Housing Element and submits an annual expenditure plan to the State. The City is estimated to receive approximately \$3.4 million annually from this new source, although that amount will vary per the volume of real estate recordings. Funding will come to the City beginning in FY 2019/20. The eligible uses for SB 2 funds are flexible and include creating and preserving affordable housing for all income levels up to 150% of Area Median Income (AMI) in high-cost areas. It can also be used for homelessness response strategies, homelessness prevention, and other uses.

Additional Funding for State Housing Programs (SB 3)

Senate Bill 3 (Beall, 2017) was approved by the voters as Proposition 1 in 2018. This measure authorized the State's issuance of \$4 billion statewide for affordable housing and veterans' loan programs. Of the total, \$3 billion will fund many of the State's programs that will support affordable housing rental developments and homeownership programs. Generally, to access funds in state programs, local agencies are required to provide a matching funding source.

Measure V Narrowly Defeated

To help address the identified need for additional funds to meet the Mayor's and the City Council's affordable housing goal, the City sponsored Measure V in 2018. Measure V authorized the issuance of \$450 million in general obligation bonds for the creation of affordable housing. Unfortunately, Measure V fell just short of its two-thirds vote requirement, earning 64% of the vote.

Governor's Budget Prioritizes Housing

In early 2019, Governor Gavin Newsom proposed a State budget that would allocate \$1.7 billion in one-time and ongoing funding to build affordable and moderate-income housing and to respond to homelessness. This includes an additional ongoing \$420 million for State low-income housing tax credits, \$500 million in one-time funding for the creation of moderate-income housing, and \$200 million in one-time funding as incentives to cities that build homeless shelters or permanent supportive housing. All these sources, if approved, could help fund affordable housing development.

Potential New Funds Through Upcoming Legislation

Prior to its bill introduction deadline of February 22, 2019, the State legislature introduced over 2,500 bills, with almost 200 bills on housing and homelessness. Two bills identified thus far could provide additional State funds for affordable housing:

- AB 14 (Rivas) Would appropriate an unspecified sum from the General Fund to be expended under the Multifamily Housing Program to fund housing for homeless youths and homeless families.
- AB 694 (Irwin) Would enact the Veterans Housing and Homeless Prevention Bond Act of 2019 to authorize the issuance of bonds in an unspecified amount to provide additional funding for affordable rental housing for veterans and other uses.

Administrative Actions to Facilitate Affordable Housing Creation

The Housing Department has completed multiple efforts to facilitate affordable housing creation since the Investment Plan was adopted. The following section outlines these accomplishments.

New Underwriting Guidelines Completed

As mentioned in the adopted Investment Plan, the Housing Department engaged a consultant to assist with an update of its Multifamily Underwriting Guidelines (the Guidelines). The City last updated the Guidelines in October 2006. Since that time, the economy and affordable housing industry changed significantly. Because the document was outdated, the Housing Department had to repeatedly seek City Council authorization for exemptions to the Guidelines as it sought approval on individual projects. This caused uncertainty for developers and added time and cost to the development process.

On August 28, 2018 the City Council approved the updated [Multifamily Underwriting Guidelines](#). The guidelines provide uniform standards and program rules for multifamily rental housing developments funded by the City. They provide transparency and certainty for both the City and developers, thereby ensuring a shared understanding of terms/expectations and streamlining the underwriting process.

\$100 Million NOFA Issued

When the City accumulates sufficient funds to invest in new affordable housing developments, it issues a Notice of Funding Availability (NOFA) stating the City's intent to fund affordable housing developments that meet the City's priorities. The NOFA references funding requirements as specified in its Multifamily Underwriting Guidelines.

When the Housing Department issued a \$100 million NOFA in August 2018, the NOFA stated the City's limit of \$125,000 per unit, allowing for the stretching of valuable resources to as many affordable housing developments as possible. The NOFA reflected the approved City Council priorities listed below:

- Projects ready for immediate construction (project readiness);
- The provision of supportive housing for homeless individuals and families;
- Project cost effectiveness (keeping project costs as low as possible);
- The leverage of Affordable Housing and Sustainable Communities funding; and
- Developments proposed on City-owned sites.

The eleven selected developments reflect the City Council's overall goals for the NOFA. For additional information regarding the results of the NOFA, an [Information Memorandum](#) is available for review.

Table 2: NOFA Selection Criteria's and Results

Priority	Goal	Results
Project Readiness	Incentivize developments ready to secure financing and construction	Developments indicated readiness to apply for tax credit financing (entitlements in place and financing secured within the following timelines) • 6 months - 3 developments • 12 months - 6 developments • 18 months - 2 developments
Supportive Housing for the Homeless Population	Incentivize the creation of supportive housing (both permanent and rapid rehousing for the homeless population)	26% of the units are supportive housing • 297 Permanent Supportive Housing apartments • 54 Rapid Rehousing apartments
Project cost Effectiveness (\$125,000 per unit cap)	Incentivize cost saving construction techniques and leveraging to stretch valuable resources	\$101,200 per-unit subsidy across all 13 proposed projects
Affordable Housing and Sustainable Communities (AHSC)	AHSC program provides funding for affordable housing and infrastructure funding for the City	The largest number of AHSC applications (three) were submitted for AHSC funding this year for a total of \$48 million in potential AHSC funding: Page Street, Roosevelt, Balbach
City Owned Property	Address statutory requirements to develop affordable housing within specific timelines	Three city-owned properties were moved onto the Managed Pipeline: Balbach, Evans Lane, Gallup Mesa

The Housing Department will review the funds available at the close of each fiscal year and will release a NOFA in the subsequent fall. New affordable housing developments and developments on the waitlist may apply for these funds on an annual basis.

Priorities for Future Funding

The adopted City Council priorities will continue to apply to future NOFA rounds. As stated in the adopted Investment Plan, the funding strategy will only be modified if there is a desire to change the population to be served, a change in the programs to be funded, or a major influx of revenue from a new funding source. Thus, until or unless these situations occur, the adopted Investment Plan establishes the direction for use of existing revenue sources through FY 2022/23.

Future funding rounds will continue to prioritize funding for developments ready to secure financing and begin construction. Future funding will continue to address the ongoing needs of homeless population by making funding permanent supportive housing a priority. A review of data regarding the needs of extremely-low income residents in San José and the number of apartments in the affordable housing portfolio, demonstrates that the need continues to outpace the supply. Cost effective developments continue to be a priority for the City. Creative approaches to containing cost will be rewarded in the NOFA scoring system. Finally,

development on city-owned sites will continue to be a priority. The Housing Department is recommending two modifications to the adopted Investment Plan.

Funding for Acquisition and/or Rehabilitation of Existing Apartments

Priorities for funding in the coming year will also include a set aside of funds for acquisition and/or rehabilitation of existing developments. In these cases, a developer will propose the purchase of a market-rate rental development with the assistance of City funding. An affordability restriction associated with the funding will be placed on the property, creating new affordable housing. Previously, funds were only made available for new construction, not allowing developers to propose this type of development. Due to concerns regarding rising costs and potential displacement of existing residents, allowing for a small investment in acquisition rehabilitation developments will open the door to creative solutions while minimizing cost and displacement. The Housing Department is recommending a set-aside of up to \$10 million in the upcoming NOFA cycle for acquisition rehabilitation. It is important to note that this type of development will increase the number of affordable units (10,000) but may will not increase the overall number of new housing units (25,000).

Minimum Investment for Extremely-Low Income

The Housing Department is recommending that at a minimum, 30% of total funds be used to fund ELI units. The Low and Moderate-Income Housing Asset Fund is the primary source of funding for new affordable housing. California Health and Safety Code Section 34176.1(a)(3)(B) requires that at least 30% of the Low and Moderate-Income Housing Asset Fund be expended for development of rental housing affordable to and occupied by households earning 30% AMI. If the Housing Department fails to comply with the Extremely-Low Income requirement in any five-year report, then the Housing Successor must ensure that at least 50% of the funds remaining in the Low and Moderate Income Housing Fund be expended in each fiscal year on households earning 30% or less of the area median income until the Housing Department demonstrates compliance with the Extremely-Low Income requirement. Additionally, the need for extremely low-income housing continues to outpace the supply.

Funding for the “Missing Middle”

The majority of funding sources used by the Housing Department to finance affordable housing are limited to assisting residents between 30% and 60% AMI. Residents earning 61% to 80% of AMI (\$63,000 to \$75,000 for a two-person household) are considered low-income but do not qualify for the majority of affordable housing in San José. Additionally, moderate-income residents earning 81% to 120% AMI struggle to afford housing. Combined, these groups make up the “Missing Middle” households that earn too much to benefit from affordable housing programs, but earn too little to comfortably afford market rate housing.

The Governor’s January Proposed Budget call for an investment of \$500 million for the development of housing for the Missing Middle through the expansion of its Mixed-Income Loan Program (MILP). The Mayor’s Budget Message issued on March 8, 2019, directs the City

Manager to identify \$10 million of Inclusionary Program fee revenue as local funds to match funding from the MILP. A commitment of local funds aligns with the State program priorities making San José developments more competitive on a state-wide basis. This priority will allow San José to build more housing for workers of modest incomes. These funds are available for this purpose and will be held until action is taken by the City Council to set aside funds for this purpose.

Revised Multi-Year Affordable Housing Projections

This section summarizes the revenue available to commit to the development of new affordable housing. The report includes all of the funding sources available to the City to finance affordable housing. **Attachment A** provides an overview of all funding sources available for affordable housing development.

The Housing Department manages the revenue that is collected by the City for the development of affordable housing. **Attachment B** details the Housing Department's expected fund balance by source that was included in the Investment Plan which was approved by City Council in June 2018. Significant variances from the 2018 projections are summarized in the **Attachment B**. The total estimated funds available for affordable housing development for the five years encompassed by the adopted Investment Plan was \$335.1 million.

Affordable Housing Permitted, Under Construction, Complete and Managed Pipeline

As of the end of calendar year 2018, the [Production and Preservation Report](#) indicated there are 946 affordable apartments permitted, under construction and completed since January 1, 2018. Since the adoption of the Investment Plan, specific affordable housing developments were moved into the managed pipeline and funds were set-aside for moderate income households. Over \$100 million in funds were identified for the creation of 1,146 new affordable homes.

Table 3: New Affordable Housing Managed Pipeline

Source	\$100 Million NOFA – City Council Commitments	\$100 Million NOFA – Managed Pipeline	Moderate Income Set-Aside
Low and Moderate Income Housing Fund	\$21,714,960	\$70,911,364	\$0
Affordable Housing Impact Fees	\$500,000	\$0	\$229,460
Inclusionary Housing Policy In-Lieu Fees	\$0	\$0	\$0
HOME	\$6,000,000	\$0	\$0
TOTALS	\$28,214,960	\$70,911,364	\$229,460
Total Funds Set Aside			\$99,355,784
ESTIMATED AFFORDABLE HOMES			1,146

Updated Revenue Projections

The Housing Department has revised its fund balance figures and future revenue projections for the five-year time period from FY 2018/19 to 2022/23. The set-asides stated in **Table 3** above have been subtracted from the revised figures listed in **Table 4** below. The Revised Affordable Housing Revenue Projections show an additional \$176 million through FY 2022/23.

Table 4: Updated Affordable Housing Revenue Projection

Source	FY 17/18 Year End Available for Development	FY 18/19 Estimated Revenue	FY 19/20 Estimated Revenue	FY 20/21 Estimated Revenue	FY 21/22 Estimated Revenue	FY 22/23 Estimated Revenue
Low and Moderate Income Housing Fund	\$8,262,000	\$23,062,000	\$4,500,000	\$3,500,000	\$3,500,000	\$3,500,000
Affordable Housing Impact Fees	\$738,000	\$511,000	\$41,488,000	\$0	\$0	\$0
Inclusionary Housing Policy In-Lieu Fees	\$10,702,000	\$12,456,000	\$15,592,000	\$1,780,000	\$1,770,000	\$1,770,000
Inclusionary Housing Ordinance In-Lieu Fees	\$0	\$3,251,000	\$2,675,000	\$2,842,000	\$0	\$0
Housing Authority Litigation Award	\$8,908,000	\$0	\$0	\$0	\$0	\$0
HOME	\$0	\$4,048,000	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
SB2 State Housing Trust Fund	\$0	\$0	\$3,400,000	\$3,400,000	\$3,400,000	\$3,400,000
TOTALS	\$28,610,000	\$43,328,000	\$69,655,000	\$13,522,000	\$10,670,000	\$10,670,000
Total Funding for Affordable Housing						\$176,455,000
ESTIMATED AFFORDABLE UNITS						1,412

The projected revenue is received from various one-time and on-going revenue sources that are required to be used for affordable housing development and/or related purposes.

Updated Production Target

The updated revenue projection states that the Housing Department has \$176 million available to finance 1,412 new affordable deed-restricted apartments over the next five years. This assumption is based on the maximum funding limit of \$125,000 per apartment. **Table 5** below provides a revised projection of the total number of affordable apartments that can be created in

San José from a combination of Housing Department financing and opportunities outside of the City resulting in new affordable housing.

Table 5: Number of Affordable Housing Units that can be Created by FY 2022/23

OPPORTUNITIES	ESTIMATED NEW UNDUPLICATED UNITS
City of San José Financing	
- Apartments Permitted, Under Construction and Completed	946
- Affordable Housing Managed Pipeline	1,146
- Affordable Housing Revenue Projections	1,412
Measure A	260
Inclusionary On-site	88
VTA sites	420
Teacher Housing	100
Housing Authority Sites	600
Private Development	300
Accessory Dwelling Units	500
Total	5,771

Given that the total number of affordable units projected to be funded from all sources during the next five years is 5,771 apartments. Additional resources and incentives are needed to meet the City's goal of 10,000 new affordable homes. At \$125,000 per unit, the City would need \$528 million to fund the balance of 4,229 units.

Revisit a General Obligation Bond Measure

The narrow defeat of Measure V suggests that future voters may be supportive in passing a general obligation bond measure for affordable housing. The Mayor's March Budget Message for Fiscal Year 2019/20, which is scheduled for City Council review and approval on March 19, 2019, directs the City Manager to fund ballot measure polling to determine whether the City should place a general obligation bond measure for affordable housing on the ballot for the 2020 election. Funds from a general obligation bond could be used to finance the acquisition, rehabilitation and construction of affordable housing.

Upcoming Policy Initiatives

In Spring, 2019, the Housing Department will begin work on two initiatives that will impact the location of future affordable housing in San José. The first project involves updating San José's Fair Housing Plan as required by the Federal Government and in concert with California Assembly Bill 686 (2018). The Plan will explore ways to take meaningful actions that combat discrimination, overcome patterns of discrimination, and foster inclusive communities free from barriers to opportunity based on race, ethnicity and other protected classes.

In addition, the Housing Department will modernize its affordable housing dispersion policy to guide where City-financed affordable development will occur. This policy would help ensure that affordable housing is distributed throughout the city, particularly in areas with access to high quality transit, job centers, parks, libraries, quality schools, and other amenities. Together these initiatives will influence how and where the City funds future affordable housing.

Finally, the Housing Department will provide a report to the City Council describing the financing required for affordable housing and the overall cost of development. Funding for affordable housing is limited, strategies must also be put in place to stretch every dollar available.

PUBLIC OUTREACH

The updated Investment Plan was reviewed and discussed at the public meeting of the Housing and Community Development Commission on March 14, 2019. Additionally, this memo was posted to the March 25, 2019 agenda for the Community and Economic Development Committee.

EVALUATION AND FOLLOW-UP

The Production and Preservation Report, posted on the City's website, provides an update on the progress towards meeting the 10,000-unit affordable housing goal.

COST IMPLICATIONS

Funding requests for specific developments will be brought forth individually to City Council for approval.

COORDINATION

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

COMMISSION RECOMMENDATION

The Housing and Community Development Commission will receive this update at its March 14, 2019 meeting. Any specific recommendations will be summarized in a supplemental report to this memorandum.

March 11, 2019

Subject: Affordable Housing Investment Plan Update

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CEQA

Not a Project, PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

/s/

JACKY MORALES-FERRAND

Director of Housing

For questions, please contact Rachel VanderVeen, Deputy Director, at (408) 535-8231.

Attachments:

Attachment A – Funding Sources Description

Attachment B – Prior Year Revenue Projections