COUNCIL AGENDA: 12/15/2020
ITEM: 3.10
FILE NO: 20-1684

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: **SEE BELOW**

DATE: December 15, 2020

SUBJECT: JPA-issued Bonds for Moderate-Income Housing.

<u>Recommendation</u>

As recommended by the Rules and Open Government Committee on December 2, 2020:
Accept the staff report that provides a summary of staff analysis and work to-date on two unsolicited proposals for the City to join a joint powers authority for moderate-income rental housing sponsored by the California Community Housing Agency, and alternatively comparable program by the California Statewide Communities Development Authority.
CEQA: Not a Project, File No. PP17-010, City Organizational and Administrative Activities resulting in no changes to the physical environment. (Housing, Finance and Economic Development)
[Rules Committee referral 12/2/2020 - Item G.4]

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: RULES AND OPEN GOVERNMENT COMMITTEE

FROM: Jacky Morales-Ferrand
Julia H. Cooper
Nanci Klein

SUBJECT: **SEE BELOW**

DATE: November 23, 2020

Approved D. DSyL

Date 11/25/20

SUBJECT: PUBLIC PURPOSE BONDS ISSUED BY A JOINT POWERS AUTHORITY FOR MODERATE-INCOME RENTAL HOUSING

RECOMMENDATION

Accept the staff report that provides a summary of staff analysis and work to-date on two unsolicited proposals for the City to join a joint powers authority for moderate-income rental housing sponsored by the California Community Housing Agency (CalCHA), and alternatively comparable program by the California Statewide Communities Development Authority (CSCDA).

BACKGROUND

On June 25, 2019, the City Council approved the Housing Department staff's update on its development of moderate-income housing strategies. Included in that memorandum and presentation was a brief description of a moderate-income housing program proposed by the California Community Housing Agency (CalCHA), a newly formed joint powers authority established by Kings County in 2019. This information was also presented to the City Council's Committee on Community and Economic Development on May 20, 2019.

In 2019, Housing Department staff led a team with staff from Finance, the Office of Economic Development, and the City Attorney's Office that met several times with representatives of Catalyst Housing and the CalCHA team. The team also consulted an external advisor who did preliminary analysis on the CalCHA product. By November 2019, staff had identified remaining structural questions and concerns that would require significant additional effort to resolve, and in early 2020 was beginning to work through selected issues to possibly bring the product to the City Council for further direction. However, the onset of the COVID pandemic and key Housing Department staff turnover redirected the focus of Housing's Policy and Production Teams. They focused instead on pressing housing issues relating to the impact of the pandemic including the City's eviction moratorium, a moratorium on rent increases, and the grantmaking for rental assistance and other essential services such as food provision, community Wi-Fi, and microenterprise support. The Housing Policy Team then prioritized its time-sensitive Citywide Residential Anti-Displacement Strategy and Diridon Affordable Housing Implementation Plan work. The Finance Department has also been unable to continue to work on reviewing the proposal because of COVID-19.

On October 28, 2020, Councilmembers Khamis and Diep authored a memo to the Rules Committee recommending the City join CalCHA. At that Rules Committee meeting, staff provided feedback that the requested actions would require additional staff time from within the Housing Department and other departments, including Finance and Office of Economic Development, and would need to be prioritized through the next Council Priority Setting Session. However, following further discussion, staff committed to providing an update at the Rules Committee meeting on December 2, 2020, with the help of staff from the Office of Economic Development.

In late August and early November 2020, staff met with representatives from the California Statewide Communities Development Authority (CSCDA) to learn more about their new program for moderate-income housing.

Need for Moderate-income Rental Housing

An estimated 65,354 households in San José qualify as moderate-income - approximately 20% of all households in the City.[1] Moderate-income households earn between 81 and 120% of the Area Median Income (AMI). In 2020, a single person would be moderate-income if they earned between $78,550 and $118,950, and a family of four would earn between $112,150 and $169,900.[2] Restricted affordable apartments for moderate-income households constitute only a small portion of the City's affordable housing portfolio. Only about 5% of the more than 16,000 income-restricted apartments for which the City administers affordability in its portfolio qualify as moderate-income.

Moderate-income housing remains very difficult to finance given the lack of subsidies and affordable housing funding programs for this income group. The most common affordable housing financing sources such as federal and State Low Income Housing Tax Credits and multifamily housing revenue bonds focus on lower-income housing and cannot serve moderate-income apartments. These programs generally support only renters at or below 60% AMI, with a few newer apartments also serving up to 80% AMI renters.

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[1] American Community Survey One-year Estimates for San José, 2017.

[2] City of San José Housing Department Rent and Income Limit Tables Effective Date June 1, 2020, https://www.sanjoseca.gov/home/showdocument?id=61061.

Similarly, only a small amount of the City's current sources of funding can finance moderate-income rental housing. Inclusionary Housing Ordinance in-lieu fees, Inclusionary Policy in-lieu fees, and Measure E funding can serve this income group, as well as lower-income levels.[3] However, once it is amended in early 2021, the Inclusionary Housing Ordinance will serve a wider range of incomes that will allow developers to include one-third of their on-site rental requirement as moderate-income apartments. On November 5, 2019, the City Council approved changes to income targets in the Ordinance. The on-site Inclusionary Housing rental requirement has a 15% affordable set-aside, with one income target now allowing 5% of units to be provided for moderate-income renters at 100% AMI.[4] The for-sale inclusionary requirement continues to target moderate-income households at or below 120% AMI.

New Strategy for Creating Moderate-Income Housing

New programs to create restricted affordable housing for moderate-income residents have been developed and now are being marketed by two separate entities with some similarities in their proposed structures, but also some significant differences. Each was formed through the creation of a joint powers authority (JPA). As with other JPAs to which the City belongs, the JPA structure allows the JPA to leverage the authorities of each of the individual members. Each program is premised on purchasing existing market rate multi-family housing and reducing rents through a combination of eliminating property taxes paid to the City, the County, School Districts, other overlapping jurisdictions and accessing low cost financing. The JPA structure allows each JPA to issue long-term, tax exempt public purpose bonds under the Mark-Roos pooling act, similar to other JPAs used by the City. The proceeds from these bonds would be used to acquire existing, new market rate multifamily properties. The ability to issue such bonds will be based on the City's membership in the JPA and the City's existing authority to issue such revenue bonds.

As with multifamily housing revenue bonds issued to acquire or build affordable housing, the repayment obligation of the JPA's Marks Roos revenue bonds is payable solely out of the revenues and receipts derived from the project being acquired with bond proceeds. These JPAs will not issue bonds unless the governing body of the city in which a proposed project is located approves the issuance of the bonds. Bonds are issued as limited obligations of the JPA and not of the city or other individual JPA members.

The bonds are used to acquire existing multifamily housing, typically newly-constructed properties that may or may not be fully leased up. As a government-owned asset, the properties would not be subject to real estate taxes. This tax exemption allows operating costs to stay low enough to enable units to be income-restricted without any additional subsidy if properties are large enough to realize economies of scale in operations. Rents would be set at income levels

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[3] Commercial Linkage Fee revenues will also be able to serve moderate-income housing needs; however, no revenues are expected in the next three to four years.

[4] Further, the City's Ellis Act (also directed by the City Council to be amended on November 5th) refers to the Inclusionary Housing Ordinance as part of its re-control options for rent-stabilized apartments that will be torn down and brought back onto the market.

that the City may have some control over, to the extent feasible, in conjunction with the bond issuance. For example, a development might have one-third of its apartments at 90% Area Median Income (AMI), one-third at 100% AMI, and one-third at 110% AMI. Recent projects by CalCHA have been offered at 120% of AMI. Further, the City could negotiate to cap tenants' rent increases at no more than 4% per year. Purchase of an existing property would not involve displacement of existing tenants. Existing tenants in a building that is acquired and who qualify for income-restricted apartments would be offered below-market rents. Non-income-qualifying tenants would be allowed to stay at their current rent until they leave voluntarily, with those apartments converting to restricted affordability with income-qualifying tenants upon turnover. As a result, although the tax benefits would flow to the projects immediately, the delivery of workforce affordability would be necessarily deferred to avoid displacement.

The use of these products thus far has primarily been used to acquire newer apartment buildings with basically no needed capital improvements. In theory, the strategy could be used for new construction, but added requirements due to waived property taxes, and additional risks associated with escalating materials and labor costs, overseeing construction, and managing lease-up would likely make it difficult without additional subsidy in the current cost environment. This type of bond issuance could also be used to acquire and rehabilitate older buildings. However, the amount of capital needed for substantial rehabilitation for older buildings is a different business model, would also involve construction risk and materials and labor costs, and may also require subsidies.

The processes to use the products is very similar, as follows. The City would enter into an agreement that usually contains an option to purchase after year 15 through year 30. The City's exercise of this option would not require any new financial investment from the City, only the assumption of any remaining debt to be paid by the revenues from the property. To provide the City with public benefits, as is required for the use of this type of bond financing, any annual surplus cash and/or sale proceeds generated by the property after the payment of expenses and debt would be provided to the City. If there is any remaining revenue, it would likely flow to the City near or at the end of the bonds' term. If the City never exercised its option to purchase the property, the JPA would sell the property after year 30 and the City would receive the net sales proceeds.

If the City took possession of the property, the City would have full control over its operations and affordability. The City could choose to change the property's income restrictions, restructure its financing, convey it to a nonprofit developer/owner, ensure that rehabilitation occurs, and/or create a ground lease structure to ensure ongoing affordability at that location.

California Community Housing Agency (CalCHA)

CalCHA was formed pursuant to a joint powers authority with two original charter members, Kings County and the Housing Authority of Kings County. CalCHA is a political subdivision of the State of California under the Joint Powers Act and is authorized to issue revenue bonds and to conduct a range of activities including acquisition, ownership, maintenance and operation of any property. Additional cities, counties, and other local government entities may, and have, joined CalCHA. This includes the cities of Menlo Park, Santa Rosa, Mountain View, and Fairfield, among others. The City has no existing relationship with this newly formed JPA and no large city peer of the City yet belongs to CalCHA JPA. CalCHA hires and fires the asset manager (currently, Catalyst Housing Group).

California Statewide Communities Development Authority (CSCDA)

The California Statewide Communities Development Authority (CSCDA) is a joint powers authority founded and sponsored by the League of California Cities and the California State Association of Counties. CSCDA was created in 1988 to enable local government and eligible private entities access to low-cost, tax-exempt financing for projects that provide public benefit. CSCDA is comprised of more than 530 cities, counties and special districts, including the City of San José, which has been a member since 1990. CSCDA has issued more than $65 billion through 1,700 plus transactions across its diverse public benefit financing programs.

Recently, CSCDA has created an affiliate joint powers authority in order to create its own moderate-income housing program. The City of Anaheim has recently become a member. CSCDA expects the Cities of Oakland, Long Beach, and Los Angeles to join in the coming months. The basics of the new program are similarly structured to CalCHA, but with some distinctions.

ANALYSIS

The Housing Department believes these new programs present potential options for turning some existing market-rate housing in San José into moderate-income housing with no upfront funding from the City. Both programs utilize the same strategy of issuing public purpose bonds to fund acquisition of housing that eventually becomes income-restricted for moderate-income households.

Both programs have represented that they offer several advantages:

- Income-restricted moderate-income housing
- Ability to cap rent escalations for residents at 4% per year
- Creation of potentially significant revenues to be used for affordable housing, homelessness, preservation, other anti-displacement strategies, or other City needs in the long-term
- Relatively little financial risk to the City
- Ability to avoid displacement of existing residents when buildings are acquired
- Ability to implement other City policies, such as tenant preferences, in these buildings

- A minimum of staff time spent in creation of affordable units.

Finance has pointed out that there are, however, a number of significant costs and risks that the City will need to consider. Both programs derive their ability to marginally reduce market-rate rents based on the City (and other taxing entities) foregoing property taxes on these properties and by acquiring the properties with low-cost tax-exempt bonds also derived from the cities powers. As such the Council will need to consider these broad policy issues:

- Given that the programs rely heavily on contribution of City tax revenues and borrowing authority, is either program the most efficient means of delivering the benefits, or could other governmental or nonprofit providers or the City itself provide those benefits more readily?

- If such public resources are devoted to the success of these projects, should other housing entities be offered the same opportunity to compete for the same right to provide housing without paying property taxes and having access to JPA bonds?

Before proceeding with either JPA membership, there are several concerns and questions regarding these new programs that staff needs additional time to assess:

- *Impact on other taxing entities* – Since these properties are exempt from real estate taxes, this loss in revenue affects other taxing entities beyond the City such as the County and school districts. While the CSCDA product assumes that the City, at its discretion, would share some portion of proceeds generated by the property with other taxing entities, the CalCHA product does not. Given the difficult financial situation of local governments and school districts given the COVID downturn, staff needs additional time to understand these implications and a chance to further communicate with these other entities prior to joining.

- *Position of State* – As the granting of tax exemption to existing housing also impacts school district revenues, and by extension the State’s funding of schools, staff would also want to ascertain the State’s position on this program. In the 1990s, legislators became worried when a few small cities used the Marks-Roos Act to issue bonds that exceeded their capital needs. As a result, in 1998 the Legislature stopped the practice of allowing so-called “roving JPAs” to issue bonds to pay for developments outside their member agencies’ jurisdictions (SB 147, Kopp, Chapter 35, Statutes of 1998). More recently, the Legislature in 2009 imposed greater reporting requirements related to "conduit financing" bond issuances by JPAs because of a lack of transparency in the process (SB 99, Senate Committee on Local Government, Chapter 557, Statutes of 2009). Given the State’s past position on “roving JPAs” and subsequent reputational harm done to cities who had participated in such JPAs, and given the more direct financial impact of this structure on State finances, staff would want to ascertain that the State has no objections or concerns about either program.

- *Transparency* – Membership in either program requires the City Council to pass a resolution to join a joint powers authority. Each property acquired would then have an associated individual agreement with the City that covers purchase options, rent restrictions, etc. The CalCHA structure recommends an approval by the City Council for the program and approval of a delegation of authority to the City Manager or designee to approve individual property acquisitions, while CSCDA's structure allows for a public hearing for each agreement. The City's policy for issuing multifamily housing revenue bonds is to require bond issuances by third-party conduit issuers to be given a public hearing in San José. This policy responds to the State's 2009 conduit issuer concern noted above. Staff believes that if the City joins either of these entities, it is an important consideration that each property acquisition and agreement be given a local public hearing so that the community is properly informed. In addition, staff would need to be comfortable with both JPA's reporting and disclosure practices.

- *Tax-exempt status* – The strategy is premised on the tax-exempt status of the properties acquired to create the opportunity for income-restricted units. Staff needs additional time to review the basis of the tax-exempt status to understand if there is any regulatory risk of this status being revoked in the future, and what the City's role could be in such a situation.

- *Fees* – The private asset managers, bond counsel, and underwriting firms associated with each entity collect fees for their role within the structure. Staff would like additional time to review these fee levels to see how they compare, and if they are at appropriate levels.

- *Location and Number of Units* – Since the approach of the program is primarily to acquire newer apartment stock, staff would like to understand more about the potential locations of these units and the affordability levels. Current rent conditions may make market rent in some locations at similar levels to those allowed for moderate-income units, thus providing a lower overall benefit than if the product were used in higher-rent submarkets or if income targeting were lower. Staff would want to explore further whether it could control or advise where the product would be used, and how many transactions would be done in defined areas.

- *Efficiency of Affordability* – Because housing stock to be acquired is relatively new existing housing with existing tenants who qualified based on market rents, and because neither program relies on evictions, the delivery of affordability will necessarily be delayed. The City and other taxing entities would forego property taxes immediately, but the affordability benefit would be deferred. Staff needs to do additional analysis to be able to quantify how quickly this would occur and whether the loss of tax revenues represents the most efficient way of delivering that benefit.

- *Property management and condition* – The structure of these programs leaves the hiring of the property management up to the asset manager, i.e., the JPA. While this typical of market-rate apartments, staff has had previous experiences on properties with third-party bond issuers in which there was insufficient oversight and an unwillingness or inability of property managers to fulfill the City's requests to make the properties safer without using the City's formal code enforcement authority. Staff recommends that properties' bond regulatory agreements include provisions that require good maintenance of the property and would allow for the City's right to enforce safe property conditions in cases of mismanagement or if the property falls into disrepair. While there are other legal avenues for this type of enforcement, having these added avenues will help avert problems in the long run. Staff would develop recommendation for such provision and discuss with the JPAs whether they would be viable.

- *Implied Guarantees* – Both programs allow the City to buy out the project contingent on repaying all outstanding bonds. This creates a direct City interest in the amount of leverage placed on the housing (including the fees charged to the program and payable from the bonds). It also in essence has the City guarantying that the bonds will be repaid if the City ever elects to take over control of the property. Unlike property managers or JPA members from other jurisdictions, the City has a direct interest in the welfare and safety of its residents and to keep them housed. Staff needs to explore each of the scenarios that could cause the City to want or need to take over the project and ensure that it is not creating moral hazards by, in effect, guarantying projects that encounter operating or public safety difficulty, leaving the City no other options but to assume control of the projects.

- *Selection of Entity* – This is a new type of program and there are now two entities offering similar products. Staff needs time to consider each program, and the process by which the entity should be selected to ensure it complies with the City's rules. It is possible that the City could become a member of one, or both, entities. It is also possible that the City could choose another option or select a program through a competitive process. For example, the CSCDA program has a property manager based in Orange County and CalCHA has a property manager based in Marin County. Staff needs to explore whether the City would benefit by giving one or more existing property managers in San José the opportunity to use the same City resources for providing discounted rents and whether there are entities in San José that could offer the same or better outcomes if they were given the same opportunity to offer housing that doesn't pay property taxes and has access to public purpose bonds.

- *Regional Housing Needs Allocation (RHNA)* – It is not clear that the units acquired and subsequently income-restricted would count towards the City's moderate-income RHNA goals. CSCDA reports that its structure could produce units eligible for RHNA credit, but they are not now. While the City may still choose to pursue this strategy regardless of RHNA credit, this is an important consideration for the City to explore further with the State Department of Housing and Community Development prior to using these products.

RHNA credit is an important issue particularly given the increasing legal ramifications for jurisdictions not meeting their RHNA goals, as well as the forthcoming significant increase in the City's RHNA allocation for the sixth Housing Element cycle.

CONCLUSION

The Housing Department believes that these two new entities, along with the use of public purpose bonds, present an interesting opportunity to create moderate-income housing units in San José. However, staff across multiple departments needs to fully understand the financial, legal and economic implications, risks, benefits and ultimate costs of joining either, or both, of these joint powers authorities, and needs more time to answer the concerns and questions outlined in this report.

PUBLIC OUTREACH

Updates on moderate-income strategies including references to the CalCHA joint powers authority and its financial product have been heard in several public meetings previously: on May 9, 2019, at the Housing and Community Development Commission; on May 20, 2019, at the Community and Economic Development Committee; and, on June 25, 2019, at the City Council. This memo was posted to the December 2, 2020, Rules and Open Government Committee agenda.

COORDINATION

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

COST SUMMARY/IMPLICATIONS

There is no cost implication for this action.

COMMISSION RECOMMENDATION

The City's Housing and Community Development Commission heard an update on moderate-income strategies at its May 9, 2019 meeting. Commissioners' comments were wide-ranging, supporting several of the strategies mentioned in the staff memo. Comments relevant to the JPA-issued bond product included support for lowering fees (costs) to support creation of affordable housing, and the importance of producing housing at all levels of affordability.

/s/	/s/	/s/
NANCI KLEIN	JACKY MORALES-FERRAND	JULIA H. COOPER
Director, Office of Economic Development	Director, Housing	Director, Finance

For questions, please contact Jerad Ferguson, Office of Economic Development, Housing Catalyst, (408) 535-8176; Kristen Clements, Housing Department, Division Manager, at (408) 535-8236.