



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Rosalynn Hughey

SUBJECT: AFFORDABLE HOUSING
STRATEGIES STUDY SESSION

DATE: August 28, 2023

Approved

Rosalynn Hughey

Date

8/29/23

PURPOSE

The purpose of the Study Session is to provide the City Council with information regarding the “3Ps” of affordable housing, which refer to Production, Preservation, and tenant Protection.

OUTCOME

This Study Session is Part One of a two-part Study Session to educate the City Council on affordable housing programs and current conditions. This session will provide foundational information on the City’s programs in each of the 3P areas and will feature a panel of housing funders and practitioners. A presentation on housing production will also provide background information on affordable housing development and finance that will be further discussed in Part Two of the Study Session that will focus on the cost of residential development for affordable and market-rate housing, scheduled for October 26, 2023.

The 3Ps of affordable housing are a broadly accepted framework among affordable housing practitioners in California.¹ The 3Ps refer to housing production, preservation, and tenant protection, with a focus on affordable housing:

1. **Produce** enough housing for residents at all income levels;
2. **Preserve** the affordable housing that already exists; and
3. **Protect** current residents from displacement from neighborhoods that are changing rapidly.

The 3Ps framework forms the foundation on which the City can grow equitably while also mitigating displacement of low-income residents.

¹ For example, beginning in 2017, a blue ribbon task force of elected and civic leaders convened by the Association of Bay Area Governments and the Metropolitan Transportation Commission developed a set of policy recommendations called the CASA Compact to address the region’s housing crisis. For more information, see <https://mtc.ca.gov/planning/housing/committee-house-bay-area-casa> and <https://mtc.ca.gov/funding/investment-strategies-commitments/housing-solutions/housing-protection-preservation-production>.

While displacement is a complex market-created phenomenon, the City is taking a leadership role in being thoughtful about its planning and preservation policies and funding priorities to help alleviate displacement problems in both the short and long term. By focusing attention on all 3Ps at the same time, San José will improve its ability to grow sustainably while preserving its greatest asset – its existing residents.

BACKGROUND

The Housing Department is actively engaged in program administration and/or policy development for each of the 3Ps of affordable housing. This work is in accordance with the 2023-2031 Housing Element adopted by the City Council on June 20, 2023, as well as the Citywide Residential Anti-Displacement Strategy approved by the City Council on September 22, 2020.

At the City Council's March 14, 2023 meeting, Councilmembers raised several questions regarding affordable housing development during discussion of Item 8.1, "Actions Related to the Loan Commitment and Land Purchase for 797 Almaden, a New Affordable Housing Development." City Council requested a study session regarding the cost of affordable housing, including a comparison of the costs of different interim housing products and permanent supportive housing and information on the pipeline of affordable housing developments. Housing Department staff indicated that a study session could be conducted in August 2023.

Given the complexities of affordable housing development and the strategies included in the recent City Council-adopted 2023-2031 Housing Element, staff designed a two-part Study Session in response to the City Council request. Part One of the Study Session will provide a foundation on the 3Ps of affordable housing, including foundational information on the City's programs in each of the 3P areas and will feature a panel of housing funders and practitioners. Part Two of the Study Session, on October 26, 2023, will focus on the cost of residential development for affordable and market-rate housing. The presentation on production during the Part One will provide background information on affordable housing development and finance that will be further discussed during Part Two.

Additionally, the Citywide Residential Anti-Displacement Strategy adopted by City Council in 2020 provides 10 recommendations in all 3P areas on which the City should take action. Staff's research on best practices on preventing and mitigating negative effects from residential displacement indicates that strong-market cities that focus on keeping current residents in place operate programs in all 3P areas. The operation of several complimentary programs across the 3Ps helps to compensate for the fact that the need for affordable homes is rising significantly faster than cities' ability to produce them.

ANALYSIS

How the 3Ps Framework Came into Use

The 3Ps framework was developed as part of the Committee to House the Bay Area process convened by the Association of Bay Area Governments and the Metropolitan Transportation Commission in 2017-2018. San José was among the governmental entities who participated in the 3Ps development process and City elected officials and staff helped to create the framework.

Currently, the 3Ps framework is widely upheld as the gold standard for the conduct of housing policy and programs. The California Department of Housing and Community Development now requires cities to incorporate production, preservation, and protection into long-range planning efforts, including Housing Elements.

Defining the 3Ps

The 3Ps framework was created with the understanding that there are multiple kinds of affordable housing needs in the Bay Area and that complementary policies are required to address these needs. Given that affordable housing production alone is inadequate to meet the needs in robust real estate markets like San José's, supporting strategies also are needed to both preserve housing opportunities and protect lower-income renters who have fewer housing options and higher barriers to relocating than higher-income residents.

Production

Production refers to the new construction of homes that serve renter families at all income levels. Production therefore encompasses both market-rate and affordable housing construction. Given the housing affordability crisis in San José and throughout the region, the Part One Study Session focuses on the affordable housing production process.

New affordable housing production adds housing supply for a segment of the City's housing market that new market-rate development cannot serve. This is because market-rate developments primarily serve the highest-income renter households in any given area, as high rents are needed to support the large amount of financing required to cover residential construction costs. Affordable housing production occurs via two mechanisms: 1) the development of new deed-restricted affordable properties that receive public subsidies, and 2) inclusionary housing programs in which market-rate developments are obligated to produce deed-restricted affordable homes or provide other alternative contributions to housing. San José utilizes both strategies for production, although the vast majority of San José's deed-restricted affordable units have been created through the development of new 100% affordable housing properties.

In the United States, new affordable housing developments are financed through a combination of traditional bank loans, federal and state low-income housing tax credits, tax-exempt bond financing, and public subsidies through state and local agencies. Because housing construction –

both market-rate and affordable – is significantly more costly in the Bay Area and in California than in most other regions of the United States, significant public subsidies are a critically needed portion of affordable housing development financing here. State and local subsidies usually are in the form of “soft” loans that have long maturities and flexible repayment terms. Debt service payments for public loans are typically sized as a percentage of any available net operating income each year, rather than a specific dollar amount. The Housing Department’s role in supporting the new construction of affordable housing properties focuses on securing sources of affordable housing funding and administering these funds as loans to affordable housing developments.

Both low-income housing tax credits and public agency loans in California require recorded income and rent restrictions for 55 to 99 years. This is in accordance with current state law that requires affordable rental properties be restricted for at least 55 years. Older subsidy awards required only 30 years of affordability under state law. Thus, after a pre-determined number of years, affordable housing properties are at risk of losing their affordability through expiring restrictions. If they become unrestricted properties, rents may be reset at market rates. This poses a displacement risk for existing tenants.

The City’s production work includes:

- Lending funds for new affordable housing developments that are competitively awarded through the issuance of Notices of Funding Availability and City Council’s awards of subsidy;
- Purchasing land that is competitively awarded to an affordable housing developer through a Request for Proposals process;
- Operating the Inclusionary Housing program, which requires developers of market-rate housing to include affordable homes, pay an in-lieu fee, donate land, or select another alternative at their discretion;
- Administering the City’s Affordable Housing Siting Policy, which encourages the City’s investments in new developments and acquisition/rehabilitation to occur in higher-opportunity areas; and
- Working with the Planning, Building, and Code Enforcement Department to create and administer land use tools and General Plan policies that encourage the production of affordable housing.

Preservation

Preservation refers to maintaining the affordability and physical integrity of existing homes. This includes preserving the affordability of existing deed-restricted affordable homes as well as preserving affordability and habitability in unrestricted lower-cost properties that are “naturally” affordable to lower-income households.

Preservation policies and programs seek to prevent residential displacement of renter families. Residential displacement can occur for a variety of reasons, including economic (e.g., rent increases that tenants are unable to afford) or habitability (e.g., a natural disaster renders a home unlivable, or necessary maintenance on a property does not occur, resulting in a local agency issuing a "red tag" on the property that renders the property uninhabitable for existing residents). Sometimes displacement can occur due to a combination of reasons, such as when a property owner needs to increase rent to cover the cost of repairs that are necessary for the ongoing habitability of the property. The acquisition and rehabilitation of existing buildings addresses both economic and physical causes of displacement. It also provides immediate stability for existing renters by locking affordability into properties where tenants are already living and ensuring that the properties will remain adequately maintained.

There are three main types of affordable housing preservation on which the Housing Department focuses:

- Preserving the affordability of existing deed-restricted affordable homes with expiring affordability restrictions;
- Preserving the physical habitability of lower-cost apartments, single family homes, and mobilehomes by providing subsidies for property owners to reinvest in older buildings, usually in exchange for short-term rent and income restrictions;
- Preserving the affordability of existing lower-cost apartments by lending to developers that acquire and rehabilitate properties and recording affordability restrictions on these properties (hereafter referred to as acquisition/ rehabilitation).

This Study Session's discussion of preservation focuses primarily on the acquisition/ rehabilitation of lower-cost properties. The Housing Department has not regularly funded acquisition/rehabilitation projects in the past. However, as the local market has become increasingly unaffordable for long-time residents, acquisition/rehabilitation has become more needed as it can help stabilize existing households, improve properties' physical conditions, and put in place long-term housing restrictions. The majority of the largest cities across the country operate acquisition/rehabilitation programs as part of a fully functioning array of housing programs.

Similar to the financing of new construction affordable housing developments, the financing for acquisition/rehabilitation projects includes traditional bank loans and public subsidies. However, there is a scarcity of federal resources available for this use. While low-income housing tax credits can be used for acquisition/rehabilitation projects, they are mostly awarded to new affordable housing developments. Tax credits are also complicated to utilize on smaller acquisition/rehabilitation deals. Therefore, acquisition/rehabilitation projects require a larger infusion of state, regional, and local subsidies than do new construction affordable developments to make up for the lack of tax credit equity and to cover the gap between the total acquisition and rehabilitation costs and the value of the bank loan.

In addition, many acquisition/rehabilitation properties involve older apartment buildings with significant rehabilitation needs. Managing substantial rehabilitation can be complicated. The challenge of profitably managing relatively small properties is also significant. Entities acquiring and rehabilitating existing properties and successfully managing them over time as affordable housing require significant expertise in these areas. For these reasons, a key role for government includes ensuring that affordable housing providers are adequately equipped to undertake acquisition/rehabilitation work.

It is worth noting that significant regional and state resources for preservation are in development or soon will be available to nonprofit organizations in the Bay Area. For instance, if the proposed regional bond measure sponsored by the Bay Area Housing Finance Authority² gains voter approval, San José could directly receive \$10 to 20 million or more that must be spent on preservation. This bond measure is expected to be on the statewide ballot in November 2024. In anticipation for this measure's approval, the Housing Department is planning for the infusion of these resources to ensure these potential funds will best serve the community by enhancing equity and delivering cost-efficient and effective housing. By developing a regular preservation lending practice, the City could leverage significant amounts of external funding for affordable housing in the next three to 10 years.

The City's preservation work to support acquisition/rehabilitation includes:

- Requiring the City, County of Santa Clara, or other public entity to own the land under newly funded affordable housing and enter into long-term ground leases to the properties' owners to ensure affordability in perpetuity at that location;
- Lending funds for the acquisition and rehabilitation of existing housing developments, competitively awarded through staff's issuance of Notices of Funding Availability and City Council's awards of subsidy (in process); and
- Granting funds to nonprofit organizations capacity building so they can gain skills and capacity to undertake or support acquisition/rehabilitation (in process).

Protection

Tenant protection work focuses on preventing the displacement of renter families due to economic and/or legal reasons. This work can include:

- Rent stabilization policies, which protect families from excessive rent increases;
- Just cause eviction policies, which protect renter families from capricious evictions;
- Programs and services that help lower-income renters at imminent risk of eviction to remain housed, including emergency rental assistance programs, legal counseling, or legal representation in eviction proceedings that enable tenants to reach settlements with property owners and/or to be fairly represented at during court proceedings; and

² <https://bayareahousingforall.org/>

- Programs and services that support housing stability by educating both housing providers and renters on their rights and responsibilities.

Protection policies address the housing stability needs of a far larger number of lower-income renter families than production and preservation policies and programs. This is because only a small share of eligible lower-income renters will ever be served by production and preservation programs. Most lower-income renters live in private market properties, including just over one-third of the City's multifamily apartments subject to the City's Apartment Rent Ordinance. While other programs do not create immediate stability for households that live in private market homes, tenant protection programs and policies directly address resident stability.

The Housing Department's tenant protection work includes:

- Administering the City's Apartment Rent Ordinance, which limits rent increases on apartments in buildings with three or more units put in service prior to September 1979;
- Administering the City's Mobilehome Rent Ordinance, which limits rent increases on mobilehome spaces for which utility permits were issued prior to September 1979;
- Administering the City's Tenant Protection Ordinance, which provides just cause eviction protection for tenants in buildings with three or more units;
- Operating the Eviction Diversion program, which provides emergency rent assistance and supportive services to renters involved in court eviction proceedings;
- Operating Eviction Help Centers, which provide residents with information and resources to help them avoid eviction;
- Administering the City's Ellis Act Ordinance, which provides renter relocation protections and replacement housing affordability requirements when buildings covered by the Apartment Rent Ordinance are taken out of service;
- Providing grants to pay for legal services to low-income tenants and low-income owners of properties covered under the Apartment Rent Ordinance and the provision of fair housing services; and
- Funding the Homelessness Prevention System program, which aids low-income families and individuals who are at risk of losing their housing, including temporary financial assistance, legal services, and case management or other services.

Overview of the Study Session

The format for this Part One Study Session is:

- Staff presentation
- Panel presentation
- City Council discussion
- Public comment

Part One and Part Two of the Study Sessions are informational and no action by the City Council will be requested.

The staff presentation for Part One will cover:

- Data regarding incomes, jobs, rents, home sales prices, and local affordable housing stock;
- 3Ps background and context:
 - Production: affordable housing financing, funding sources, and development approval process;
 - Preservation: subsidized properties, acquisition and rehabilitation of unsubsidized properties, and reinvestment/rehabilitation of private properties;
 - Protection: the Apartment Rent Ordinance, Tenant Protection Ordinance, eviction prevention, exploring a tenant's right to counsel and alternatives, and COVID-19-related protection measures.

The panel presentation features the following perspectives and panelists, listed in alphabetical order:

Housing Provider: **Anil Babbar, Senior Vice President of Local Public Affairs, California Apartment Association:** The California Apartment Association is the nation's largest statewide trade group representing owners, investors, developers, managers, and suppliers of rental homes and apartment communities. Anil Babbar manages local public and legislative affairs for the California Apartment Association in Santa Cruz and Santa Clara counties. Prior to joining the California Apartment Association, Mr. Babbar held government affairs roles for Pacific Gas and Electric and the Santa Clara County Association of REALTORS. He will speak about housing provider interests.

Tenant Protection Programs Counsel: **Stephen Lewis, California Rent Stabilization Network:** The California Rent Stabilization Network is a peer network of cities in California that operate rent stabilization programs. Stephen Lewis practiced municipal and constitutional law for 25 years. He served as General Counsel for the City of Santa Monica Rent Control Board from 2010 through the end of 2020, and currently provides information and advice to rent stabilization jurisdictions throughout the state. He will speak about tenant protections.

Housing Developer: **Chris Neale, President, The Core Companies:** The Core Companies is an prolific real estate development and construction firm that is active in San José, developing and operating both market-rate and affordable housing. Chris Neale's responsibilities at The Core Companies span acquisition, entitlement, financing, and construction of new housing. He will speak about production.

Funder and Policy Convener: **Khanh Russo, Vice President of Policy and Innovation, The San Francisco Foundation:** The San Francisco Foundation is a community foundation focused

on economic inclusion and racial equity throughout the Bay Area. Khanh Russo oversees grantmaking, partnerships, and policy advocacy at the San Francisco Foundation related to affordable housing. He will provide an overview of the 3Ps framework and a regional perspective.

Moderator: **Regina Celestin Williams, Executive Director, SV@Home:** SV@Home is a membership organization that works with a broad coalition of strategic partners to address our area's urgent housing needs by boosting the production of homes at all income levels, preserving existing affordable homes, and protecting the families in them. Regina Celestin Williams has led SV@Home since 2021, and previously served as Director of Housing Development at the San José-based nonprofit First Community Housing, as a consultant at the National Development Council, and as a property rehabilitation funder at the National Housing Trust. Ms. Williams' career on both the East and West Coasts has advanced housing and economic justice through affordable housing and community development. She will serve as the panel's moderator.

Funder and Technical Assistance Provider: **Cindy Wu, Executive Director, Local Initiatives Support Corporation Bay Area:** Local Initiatives Support Corporation is a national nonprofit intermediary that funds and supports affordable housing and community development across the United States. Local Initiatives Support Corporation originates hundreds of millions of dollars in affordable housing loans, in addition to providing grants and equity for affordable housing development. Cindy Wu oversees Local Initiatives Support Corporation's local affordable housing preservation and production lending and technical assistance. She will speak about preservation.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the September 7, 2023 Study Session.

/s/
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Director

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