CED AGENDA: 4/23/18
ITEM: D (2)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: April 9, 2018

Approved Kim Walesh

Date April 9, 2018

SUBJECT: FY 2017/18 – FY 2021/22 AFFORDABLE HOUSING INVESTMENT PLAN

RECOMMENDATION

Accept the staff report regarding the FY 2017/18 - FY 2021/22 Affordable Housing Investment Plan and provide direction to the Administration on the potential strategies to explore further to help meet the City Council's goals for affordable housing production.

EXECUTIVE SUMMARY

The need for affordable housing in San Jose continues to outpace the funding sources necessary to develop apartments accessible to low and moderate income individuals and families. Fortunately, there are new opportunities that will help towards meeting the demand. However, these opportunities will be insufficient to meet the City's goal to produce 10,000 affordable apartments within five years.

This document serves as the City's Affordable Housing Investment Plan (AHIP). The AHIP summarizes the Housing Department's strategy to meet the housing demand given current funding. It quantifies the available funding for affordable housing and identifies priorities as to how the City intends to invest its affordable housing resources. The AHIP also identifies potential funding sources and changes to policies and/or procedures to facilitate the development of affordable housing.

The FY 2017/18 - FY 2021/22 AHIP also provides information regarding the funding, policy work, and implementation strategy needed to develop as many affordable apartments as quickly as possible while creating a pipeline of projects that may be quickly funded as money becomes available. A key difference between this Plan and the two previously adopted plans is that the previous Investment Plans were focused on expenditures for the next fiscal year.

The Housing Department intends to use this document to guide affordable housing development for the next five fiscal years.

A summary of the topics covered in the FY 2017/18 - FY 2021/22 AHIP is provided below.

- A City of San Jose multi-year revenue projection of affordable housing revenue.
- A proposed use of affordable housing funds
- An update of the moderate-income strategy workplan.
- The issuance of Notice of Funding Availability (NOFA) to solicit interest from qualified developers.
- An estimate of the total number of affordable units produced based on projections of all resources and opportunities.
- Potential funding sources and strategies to address the projected shortfall in affordable housing funds needed to meet Mayor and City Council 10,000 unit goal.

If the proposed AHIP is approved by the City Council, it is estimated that 2,407 new affordable housing units will be added to the 1,099 units currently funded or under construction for a total of 3,506 new affordable units that will be created, under construction or funded by the end of FY 2021/22.

In addition to City funded sites, additional affordable housing will be funded from non-City sources. The total to be funded and built from all sources during the next five years is 5,667 units. This memorandum indicates that despite the availability of new funding sources and organizational capacity to produce more affordable housing, there is a significant shortfall in meeting the affordable housing production goal established by the Mayor and City Council. The proposed goal of providing 10,000 affordable units cannot be met without additional resources or implementing new strategies. This memorandum concludes with potential strategies to meet this shortfall. These strategies include potential new funding sources, modification of land use regulations, land acquisition strategies, and administrative options. Some of them require further coordination with other departments and stakeholders.

BACKGROUND

The City of San Jose has been a national leader in the development of affordable housing. Since 1988, the Housing Department has leveraged approximately $1.1 billion in City resources to attract an additional $5 billion in public and private capital to create more than 21,100 new and newly-affordable apartments and homes.

There is a Significant Need for Affordable Housing

Despite this success, the need for affordable housing in San Jose continues to outpace the construction of subsidized housing. In San Jose, nearly 20% of households are "severely cost-burdened." This means that residents are paying more than 50% of their gross income on housing, leaving an insufficient income to pay for their other needs such as food, clothing, medical care and transportation.[1] A 2017 survey of 406 urban markets in nine countries ranked San Jose as the 5th most unaffordable housing market overall, ahead of Los Angeles and San Francisco.[2] For a household to afford a one-bedroom apartment in the San Jose metro area requires 130 hours of minimum wage work per week, or more than three full-time minimum wage jobs.[3] The 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 accept substandard housing. 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 Jose will need to build more than 3,423 new income restricted homes per year for the next 5.8 years to keep up with population growth.[4] These goals are divided by income category, with an annual goal for extremely low-income (ELI), very low-income (VLI), low-income (LI), Moderate, and market-rate homes. An explanation of these income categories can be found in Attachment A (Affordable Housing Target Populations). 2017 marked the fourth year of the current RHNA production period from January 2014 – October 2022.

Given the limited resources, San Jose has been able to meet only 33% of its total RHNA goal thus far. Achievements by income category vary significantly. Since the start of the RHNA production period in 2014, San Jose was able to meet 72% of its total market-rate home production goal, but met only 7% of its affordable housing goal.

There is a Significant Need for Permanent Supportive Housing

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 Jose are homeless, with over two-thirds living on the streets or in encampments. 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.

While some of these residents can resolve their own homelessness through limited or one-time assistance, more than 1,200 people are chronically homeless. The chronically homeless often have mental or physical disabilities that prevent them from becoming economically self-sufficient. Therefore, permanent supportive housing is needed to address the unique needs of chronically homeless residents. These developments often require project-based rental subsidies, as well as on-site social and health services. Most recently, costs for services are typically provided through County of Santa Clara (County) funds, while project-based rental subsidies

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[1] HUD Comprehensive Housing Affordability Strategy (CHAS) for San Jose City, 2009-2013
[2] National Housing Conference, *Paycheck to Paycheck 2016.*
[3] National Low Income Housing Coalition, *Out of Reach 2016.*
[4] San Jose Housing Element Report, December 2016.

typically come from the Housing Authority of Santa Clara County (Housing Authority). Thus, sustainable funding of permanent supportive housing requires a collaboration between cities, counties, housing authorities, and the State.

Affordable Housing Investment Plan

The AHIP 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. The City Council last approved versions of the AHIP in late 2015 (FY 2015/16 – FY 2016/17 AHIP) and early 2017 (FY 2016/17 – FY 2017/18 AHIP). Those plans focused primarily on developing supportive housing opportunities for the chronically homeless by partnering with the County and the Housing Authority on Measure A-funded projects to serve a range of populations, including very low and low-income households. In addition, the most recent AHIP stated the intention to develop strategies for serving moderate-income households through new policies that would seek to minimize limited City affordable housing resources and maximize private investment to meet this need.

The adopted FY 2016/17 – FY 2017/18 Investment Plan identified the development of 1,196 affordable apartments in San Jose of which 651 would be set-aside for formerly homeless individuals. A status of all affordable developments that were funded, are under construction, or have been completed thus far in FY 2017/18, is provided in the *Affordable Housing Production Status Report* included with this memo as Attachment B. As shown in the attachment, a total of 1,099 apartments have received some form of funding or other approval from the City. An additional 848 apartments are currently pursuing planning approvals or funding applications.

City of San Jose Funding for Affordable Housing

The Housing Department manages various sources of funding that are dedicated to the development of affordable housing. These funding sources have different funding requirements and restrictions that the City must adhere to and enforce. For more detailed information on the different sources for funding affordable housing and their funding restrictions, please see Attachment C.

Funds and Incentives for Affordable Housing have been Eliminated or Reduced

The elimination of redevelopment by the State in 2012 dealt a major blow to the funding available for affordable housing. By law, redevelopment agencies were required to set aside a minimum of 20% of gross tax increment to increase, preserve, or rehabilitate affordable housing. In its final years, redevelopment provided the City with approximately $40 million a year for affordable housing. A portion of these funds were set-aside to repay bonds that had been issued to support the development of affordable housing. This left approximately $15 million that could have been used to fund new projects on an annual basis which is now no longer available.

With the exception of the most recent federal budget, federal funds for affordable housing have also been reduced significantly. The HOME Investment Partnership Program is the primary federal funding source that can be used for affordable housing. Since FY 2010/11, the City's HOME allocation has been reduced by 46% from $4.7 million to $2.5 million per year. Community Development Block Grant (CDBG) funds can be used to purchase land for affordable housing. CDBG funds have been reduced from $10.9 to $9.2 million during the same period. The recently approved federal budget provides a 43.4% increase in the HOME program and a 7.8% increase in CDBG funding, despite President Trump's recommendation to eliminate both programs in his proposed budget. Staff has yet to receive an award letter from HUD to determine how much of the increase will be allocated directly to the City.

In the past, the City provided other incentives to support the development of affordable housing. These incentives have either been eliminated or reduced. From 1988-2011, the City offered four construction tax exemptions and fee deferrals for housing developed for lower-income households. From 1988 – 2010, the City also exempted low and very-low income from the payment of the Parkland Dedication fees. This exemption was amended in 2010 to require that affordable units pay 50% of the fee. Further in the past, the City provided expedited processing for affordable housing development applications. This service is no longer provided.

New Funding, Legislation, and Opportunities for Affordable Housing Have Emerged

Fortunately, recent decisions by voters and the State Legislature have added resources to partially offset the loss of funds previously discussed. Recent efforts to address the affordable housing need include: County Measure A Funds; State legislation and new programs; and the Santa Clara Valley Transit Authority Affordable Housing Policy. These opportunities are discussed below.

Voters Approve County of Santa Clara Measure A Bonds

Santa Clara County Voters approved the landmark Housing Bond, Ballot Measure A to support new affordable housing in November 2016. Measure A authorizes the County to issue $950 million in general obligation bonds to be repaid by a new parcel tax for affordable housing. 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. At least $700 million will be used to serve households who are extremely low-income (ELI) and $100 million will assist very low-income (VLI) households. Up to $150 million of the total bond may be spent for moderate-income families. This includes a maximum of $50 million for first-time homebuyer programs. The total production goal is 1,800 apartments of permanent supportive housing; 1,600 rapid rehousing or transition in place opportunities; 800 apartments of ELI housing; and 600 apartments of VLI housing.

The first issuance of $250 million was approved in October 2017 and the County Board of Supervisors approved its first commitments in November 2017. To date, the Board has committed $44 million in funding for six developments which include a total of 352 apartments. Three developments totaling 219 apartments will be located in San Jose at a combined investment of $30.5 million. The Board has also issued $25 million in general obligation bonds to fund a down payment assistance program for households earning up to 120% of the area median income (AMI).

New Programs and Recently Enacted State Legislation

In 2016, the California Legislature approved AB 1618, the "No Place Like Home" program, which provides funding to counties to prevent and address homelessness. The program provides $2 billion for the construction and rehabilitation of permanent supportive housing for homeless individuals with mental illness. The County of Santa Clara is estimated to receive $10,328,363 based on having the fourth largest homeless population. It is anticipated that the State will release funding next year.

On September 15, 2017, the last day of the 2017 legislative session, the California Legislature responded to the state's housing crisis by passing 15 bills in a landmark housing package some of which will raise additional funds for affordable housing. The Governor signed all 15 bills on September 29, 2017. A brief description of the bills most impactful to affordable housing production is provided below:

- *SB2 – The Building Homes and Jobs Act*
  SB 2 provides a "permanent source" of funding for affordable housing by imposing a $75 fee on each recorded document up to a maximum of $225 per transaction per parcel, estimated to generate $250 million annually, statewide.

- *SB 35 - Streamlined Approval Process*
  SB 35 creates a streamlined entitlements approval process for housing in cities that are not meeting their state-mandated housing goals. As San Jose did not meet its State affordable housing goals in the last half-cycle, streamlining applies to developments that meet certain defined parameters. This includes the requirement that at least 50% of the units in the development are restricted as affordable.

- *AB 1505 – Inclusionary Housing*
  AB 1505 clarified the Legislature's intent to supersedes the court decision in *Palmer v. City of Los Angeles*, thereby making inclusionary housing requirements apply to rental developments. As a result of this bill, the City Council has provided a transition period and the City's Inclusionary Housing Ordinance will be applied to rental projects for which applications for First Approval are submitted after June 30, 2018.

Santa Clara Valley Transit Authority (VTA)

In 2016, the Santa Clara VTA established an Affordable Housing Policy that requires at least 20% affordable housing be developed at each VTA site. In addition, the VTA established a portfolio-wide goal of providing 35% affordable units across all of their sites. While individual projects may provide a higher or lower percentage, no project may provide fewer than 20% affordable units.

The Santa Clara VTA manages an extensive portfolio of real estate assets, which may be underutilized and/or have potential to be used for Transit-Oriented Development (TOD). To create TOD areas, the VTA is pursuing the creation of high-density residential development on their properties. In San Jose alone, the VTA has initiated predevelopment activities on 16 potential sites that could provide residential development, although some of the sites in question may not be consistent with the City's General Plan or other Planning considerations.

City Council Adopts an Ambitious Affordable Housing Goal

On September 28, 2017, the Mayor issued a memorandum entitled "Responding to the Housing Crisis" that outlined a 15 point strategy leading to the development of 25,000 homes in five years, of which 10,000 would be affordable. Many of the ideas described in the Mayor's memorandum pertain to land use or other policy actions. The Housing Department is working with the Office of Economic Development and the Planning and the Building and Code Enforcement (PBCE) Department to implement a work plan in response to the strategy. This memorandum assesses the City's ability to meet the affordable housing goal with the current funding available and quantifies the amount of funding needed to meet the five year 10,000 unit affordable housing goal.

Housing Department Efforts to Facilitate a More Efficient Lending Process

In response to the pronounced need for affordable housing, the Housing Department has made a concerted effort to maximize resources and improve the efficiency of the lending process. Since 2014, the Department has added four positions to its affordable housing development team, increased its capacity by filling seven vacant positions, and restructured the Production and Asset Management Division to maximize efficiency. The Department has also engaged TCAM asset management consultants to help the City maximize repayments on its existing affordable housing loan portfolio and to develop a robust revenue projection model. The recently completed model is based on a comprehensive review of the Department's largest affordable housing loans.

Finally, staff has also engaged a consultant to assist with an update of its Multifamily Underwriting Guidelines (the Guidelines). The City last updated the Guidelines in October 2006, yet the economy and affordable housing industry have changed significantly since that time. Most recently, the California Tax Credit Allocation Committee has adopted guidelines that are different from the City's guidelines in material ways, resulting in challenges for project development. Due to the outdated document, the Housing Department has had to repeatedly seek City Council authorization for exemptions to the Guidelines as it has approved individual projects. This has caused uncertainty for developers awaiting City Council approval, and has added time and cost to the development process.

The updated Guidelines are intended to provide uniform standards and program rules for multifamily rental housing developments funded by the City. Guidelines will provide transparency and certainty for both the City and developers, thereby ensuring a shared understanding of terms/expectations and streamlining the underwriting process. The Department is completing the outreach process and will finalize the Guidelines at the conclusion of the process. The Guidelines will then be taken to the City Council for approval.

ANALYSIS

Proposed FY 2017/18 – FY 2021/22 Affordable Housing Investment Plan

This document serves as the Department's Affordable Housing Investment Plan. In previous iterations, the AHIP focused on quantifying the available funding for affordable housing and identifying an overarching goal as to how to invest its affordable housing resources. In addition to these issues, the FY 2017/18 – FY 2020/22 AHIP provides an implementation strategy needed to develop as many affordable homes as quickly as possible. The Proposed AHIP discusses the following elements.

- A multi-year revenue projection of the City's affordable housing funding sources.
- A plan for the proposed use of affordable housing resources.
- The issuance of Notice of Funding Availability (NOFA) to solicit applications from qualified developers.
- An estimate of the total number of affordable units produced based on projections of all resources and opportunities.
- Potential funding sources and strategies to meet Mayor and City Council priorities.

City of San Jose Multi-Year Revenue Projection

The Housing Department manages the revenue that is collected by the City for the development of affordable housing. The table below details the Housing Department's expected fund balance by source at the end of the current fiscal year, as well as anticipated additional revenue by source for each of the next four fiscal years. Table 1 on the proceeding page shows that the Housing Department will have an estimated $114.3 million to invest in new multifamily affordable rental development at the outset of FY 2018-19. Total projected revenue for the five years encompassed by the investment plan is $331.4 million.

Table 1 – Five-Year Affordable Housing Revenue Projection

Source	FY 17/18 Beginning Balance	FY17/18	FY 18/19	FY 19/20	FY 20/21	FY 21/22
Low and Moderate-Income Housing Fund	$69,900,000	$3,700,000	$41,100,000	$5,500,000	$5,500,000	$5,500,000
Affordable Housing Impact Fees	$0	$1,197,000	$11,995,000	$46,000	$0	$0
Inclusionary Housing Policy In-Lieu Fees	$11,400,000	$0	$10,322,000	$13,800,000	$0	$0
Inclusionary Housing Ordinance In-Lieu Fees	$0	$0	$3,251,000	$25,000,000	$55,991,000	$25,000,000
Housing Authority Litigation Award	$22,000,000	$0	$0	$0	$0	$0
HOME	$5,400,000	$0	$3,100,000	$1,000,000	$1,000,000	$1,000,000
SB2 State Housing Trust Fund	$0	$0	$0	$2,000,000	$3,000,000	$3,000,000
TOTALS	**$108,700,000**	**$4,897,000**	**$69,768,000**	**$47,346,000**	**$65,491,000**	**$34,500,000**
	Total for 17/18	**$114,297,000**			**Total**	**$331,402,000**

The projected revenue is received from various one-time and on-going revenue sources. These sources are discussed below.

- *Low and Moderate-Income Housing Affordable Fund (LMIHAF)*
  As stated earlier, TCAM has recently completed its review of over 90 of the City's most significant affordable housing assets and created a projected revenue model. This model estimates that the City can anticipate $5.5 million annually in LMIHAF repayments that can be dedicated to new affordable housing developments over the next five years. Affordable housing developers typically will seek to reinvest in their existing projects after expiration of

their tax credit compliance period because the project is eligible to receive new tax credit financing. It is anticipated that some developments will decide to repay their City loans each year when their tax credit compliance period ends. This accounts for the large increase in revenue projected for this Fund in FY 2018/19.

- *Affordable Housing Impact and Inclusionary In-Lieu Fees*
  The Housing Department expects to receive revenue based on the development of market-rate housing. For the first two fiscal years (FY 2017/18 & FY 2018/19), the revenue projections are based on Affordable Housing Agreements that have been executed for payment of fees after construction completion. Affordable Housing Agreements are executed by market-rate developers during the entitlement process. The Inclusionary Housing Policy was previously replaced for new projects and Affordable Housing Impact Fee (AHIF) is being replaced after FY 2018/19 by the rental provisions of Inclusionary Housing Ordinance (IHO). Therefore, no new fees are expected from the AHIF or the Inclusionary Housing Policy In-Lieu fee after FY 2019/20. The IHO revenue projections assume that the 15,000-unit market rate goal is met and assumes an increase in market-rate production. (Note: PBCE and OED staff are assessing the likelihood of achieving the 15,000 goal in five years, and identifying policy shifts that may be required to increase the likelihood of success. The situation with market-rate housing production will be discussed at the April 26 "Cost of Development" Study Session.)

  Since the IHO in-lieu fee is set at $125,000 per rental affordable unit and $153,000 for a for-sale affordable unit, it is anticipated that the majority of developers will pay the fee rather than provide the affordable housing. Because the fee is collected at the time the certificate of occupancy is issued, the increase in the collection of IHO in-lieu fees is expected to be generated two years after the IHO is imposed on rental developments.

  It should be noted that of the project AHIF revenues, there is $3.4 million in AHIF revenue that can only be used for moderate-income for-sale housing. These funds are not included in the revenue chart because the chart only includes funds that can be used for multi-family housing. These funds will be included in the total revenue projections for all sources.

- *HOME*
  The majority of the annual HOME allocation is currently used to fund rapid rehousing subsidies for homeless residents. The TCAM model estimates that there will be future repayments of HOME funds that have been included in the revenue projections. These HOME repayments can be reinvested into the development of new affordable housing. The estimate is for $3.1 million in FY 2018-19 and $1 million in each of the subsequent years.

- *SB2 State Housing Trust Fund*
  SB2 establishes a State Housing Trust Fund. The legislation requires that 70% of funds collected after January 1, 2019, be provided to local governments. The funds will be distributed to jurisdictions using the federal Community Development Block Grant (CDBG) formula. It is estimated that SB2 will generate approximately $250 million a year of which

83% will be allocated to cities that already receive a direct allocation of CDBG funds. Based on this formula, staff is estimating that by the second year, the City will receive an allocation of approximately $2 million in the first year and $3 million annually.

- *One-Time Payments*
  The Investment Plan incorporates $52 million in one-time funding from the following sources:

  1) Housing Authority Litigation Award (HALA) funds of which $22,700,000 was designated for development in FY 2017/18; and
  2) An anticipated $30 million in repayments from developments, owned by affiliates of the Santa Clara County Housing Authority, in FY 2018/19 for five complete projects to be deposited in the Low and Moderate-Income Housing Asset Fund (LMIHAF).

Proposed Use of Affordable Housing Funds

FY 2015/16 - 2016/17 Plan Limited Use of Funds to Very-Low and Low-Income Rental Housing

As stated, the Housing Department estimates it will have nearly $331.4 million available for the production of affordable housing over the next five years. The FY 2015/16 - FY 2016/17 Investment Plan (http://www.sanjoseca.gov/DocumentCenter/View/53880) presented different options for how the City could spend its affordable housing resources. These options included new rental housing development, homeownership programs, or major home repair programs. The income and occupation ranges for the affordable housing programs are shown in Attachment A.

The FY 2015/16 - FY 2016/17 Investment Plan directed that the City's affordable housing resources be invested in multifamily, rental housing development. In addition, this plan presented the case for prioritizing multifamily housing for the homeless. The subsequent AHIP refined this priority to invest in Measure A projects to maximize resources and create mixed-income affordable developments. The City contribution was to be used only for Very Low Income (VLI) and Low Income (LI) apartments within the Measure A projects.

The Proposed Plan Limits the Per Unit Subsidy Regardless of Income or Population

For the Proposed FY 2017/18 - FY 2021/22 AHIP, the Housing Department recommends that the City Council continue to prioritize affordable housing rental development. However, instead of limiting the investment of City funds to VLI and LI apartments, the Housing Department is proposing to cap the per unit subsidy to $125,000 per unit regardless of the target income or population. In addition to focusing on the per unit subsidy, the Housing Department will also place greater emphasis on "project readiness" in order to expedite the creation of new affordable housing opportunities.

This approach will allow the City to continue to fund much needed ELI apartments in addition to the VLI and LI apartments. The change in target incomes is also needed to meet the funding requirements of the LMIHAF. Redevelopment law requires that 30% of all LMIAHF be reinvested in ELI housing. The City will continue to work collaboratively with the County and the Housing Authority to build housing for the homeless. However, the proposed Investment Plan does not prioritize a specific income target nor population.

A key difference between the Proposed AHIP and the two previously-adopted plans is that the Housing Department intends to use this document to guide affordable housing development for five fiscal years. The Proposed AHIP 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 there is a major influx of revenue from a new funding source. Until either of those situations occur, the Proposed AHIP will set the direction for use of existing revenue sources through FY 2021/22. As always, individual developments will be brought to the City Council for funding approval.

Moderate-Income Housing Strategy is Being Developed

As stated earlier, the City has not produced any significant restricted-affordable housing for moderate-income families in recent years. Moderate-income households with two people currently are defined as those earning between $67,901 and $108,750 per year, while those with four people would earn between $84,901 and $135,950 per year. During the 1990s, the market was able to produce moderate-income housing with little financial subsidy from the City. However, housing prices have risen drastically since that time. Producing moderate price housing in today's market would likely involve the use of public subsidies.

The City needs to use the vast majority of the its limited affordable housing resources for lower-income working families. Staff recommends using only the portion of its AHIF revenues that are required to be used for moderate-income housing. This amount is estimated to be $3.4 million which is approximately 1% of the Department's estimated total resources through FY 2021/22. For this reason, last year's AHIP articulated the Housing Department's intent to explore and expand housing opportunities to moderate-income households by investigating other approaches.

Accordingly, staff is taking several actions to promote moderate-income housing. First, the Housing Department has improved the methodology for counting moderate-income homes to capture those that meet this category based on their rents, but are not income-restricted by the City. Second, the Department has hired a consultant to examine different financial models for the creation of moderate-income rental housing that could be possible in our market.

Third, the Planning, Building and Code Enforcement Department is proposing changes to the City's Accessory Dwelling Units code that could help spur production of moderate-income housing. The Housing Department is also working with the Silicon Valley Housing Trust to promote use of its new ADU financing program. Staff is also following and advocating for efforts to implement a new tool which would be created through federal tax reform, that could result in incentives to create middle-income housing in so-called Opportunity Zones.

Finally, the Housing Department is engaging a consultant to develop a moderate-income housing strategy that will look at policy incentives, potential public funding options, legislative actions, and innovative housing typologies to address the needs of the missing middle. The Department will provide a report to the Community and Economic Development Commission (CEDC) when the moderate-income strategy is completed later in 2018.

City Resources Will Fund 3,506 Apartments in Five Years

As previously stated, the Housing Department's proposed strategy is to fund a range of affordable apartments based on readiness, with a maximum funding limit of $125,000 per apartment. Based on this cap, the Housing Department is setting the following production estimates.

Table 2 – Estimated Affordable Housing Production Goal

YEAR	CITY ESTIMATED PROJECT FUNDING	ESTIMATED PRODUCTION GOAL
Attachment B		1,099
2017/2018	**$114,297,000**	671
2018/2019	**$69,768,000**	558
2019/2020	**$47,346,000**	378
2020/2021	**$65,491,000**	524
2021/2022	**$34,500,000**	276
Totals	**$331,402,000**	**3,506**

The Housing Department estimates that at $125,000 per unit, 914 new affordable apartments can be funded from the resources available in FY 2017/18. However, there are four developments (243 apartments) that already have partial funding from the City but need to complete the planning process before construction funds can be approved. Therefore, only 671 of the units are unduplicated apartments and are included in the chart above for FY 2017/18. It should also be noted that most of the FY 2017/18 funds will not be committed to developments by City Council until FY 2018/19.

Based on the amount of projected revenues, the total estimated number of apartments that will be completed during the five-year period is 3,506 affordable deed-restricted apartments. Options to increase affordable unit production are discussed later in this document.

Notice of Funding Availability to Be Released Upon City Council Approval of Plan

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 also references funding requirements as specified in its Multifamily Underwriting Guidelines.

It is the Housing Department's intention to issue a NOFA in the amount of up to $114 million for developers that can meet the City's funding priorities. As stated, the priority for these funds will be targeted to developments that meet the City's $125,000 per unit cap, regardless of the target income or population. The Housing Department will emphasize "project readiness" in order to expedite the creation of new affordable housing opportunities. It will also reward developers that use cost saving construction techniques, such as modular housing, to maximize funding resources. Additional detail on the NOFA process will be provided when the Housing Department returns to the City Council for approval of the NOFA later this fiscal year.

The City's 10,000 Unit Affordable Housing Goal Cannot Be Met with Current Resources

If the proposed AHIP is approved by the City Council, it is estimated that 2,407 new affordable apartments will be added to the 1,099 units listed in Attachment B. This will create a total of 3,506 new affordable rentals that will be funded, under construction, or completed, by the end of FY 2021/22. In addition, it is estimated that Measure A and the No Place Like Home Program will have a capacity to fund 2,460 apartment during this same timeframe. Staff estimates that 70% of the apartments will be located in San Jose. However, it is estimated only 10% of the Measure A units will be added to the affordable housing stock because it is likely the City will have funds invested in 90% of the Measure A developments. Therefore, staff estimates that the County funds will only add 168 unduplicated apartments to the total number of affordable housing units produced.

Given the level of the current inclusionary housing in-lieu fee and the required level of affordability for on-site apartments, staff estimates that the majority of developers will opt to pay the in-lieu fee instead of producing the apartments. It should be noted that if developers choose to build the apartments on site, the revenue projections would be reduced since the Housing Department would no longer be collecting the Inclusionary Housing in-lieu fees.

The Housing Authority has indicated that they plan to produce approximately 600 affordable apartments on land that they own or plan to purchase. At this time, they are estimating that they have sufficient funds to develop the housing without additional City funding. Currently, there is a 4% tax credit and tax-exempt bonds development located in San Jose that is not seeking local subsidy. This development is projected to build 300 affordable apartments for low-income seniors.

Table 3 below summarizes the total number of apartments that can be created in San Jose from all existing funding sources and opportunities.

Table 3 – Number of Affordable Housing Apartments That Can be Created in Five Years

OPPORTUNITIES	2017-2022 ESTIMATED FUNDING	ESTIMATED UNITS	ESTIMATED NEW UNDUPLICATED UNITS
City of San Jose			3,506
Measure A	$400,000,000	2,400	168
No Place Like Home	$10,328,000	60	0
Inclusionary On-site		50	50
VTA sites			427
Housing Authority Sites	N/A	600	600
Private Development	N/A	300	300
Teacher Housing Project		100	100
City of San Jose Moderate-Income Housing AHIF Funds	$3,386,000	17	17
Accessory Dwelling Units		500	500
Totals	$413,714,000	4,027	**5,668**

Given that the total number of affordable units projected to be funded from all sources during the next five years is 5,668 units, it is clear that the City's 10,000 affordable unit goal cannot be met without additional resources or incentives. At $125,000 per unit, the City would need an additional $541.5 million in order to fund the balance of 4,332 units. Potential strategies for addressing this shortfall are provided in the following section.

Potential Strategies to Meet 10,000 Unit Affordable Housing Goal

In order to meet the City's Housing goal, the Housing Department is seeking Committee input on potential strategies. These strategies include identifying new revenue sources, modifying land use policies, identifying and acquiring land, and making it easier to develop in San Jose. Some of these strategies require further coordination with PBCE, OED, and stakeholders to determine their viability, desirability, and impact on other City priorities. Further analysis will be completed when staff returns with a consolidated recommendation to Council.

New Revenue Sources Are Needed

While efforts can be made to build better, faster, smaller, and more economically built affordable housing, the cumulative results will not close the affordability gap or create enough of the type of housing most needed. There must be a form of subsidy. Additional opportunities to obtain new and leverage existing resources are discussed below.

1. *Advocate for More State Funds*
   While many communities responded to the loss of redevelopment by passing local bond measures, State funds remain a vitally important financing layer needed to create affordable

housing. During the last legislative session, the State Legislature passed SB 3, the Veterans and Affordable Housing Bond Act of 2018. SB 3 authorizes the issuance of $4 billion in State General Obligation bonds. If approved by the voters in November 2018, it will fund a range of affordable housing preservation and construction activities, infill infrastructure, and transit-oriented development. Of the total, $1 billion will be earmarked for a veteran's homeownership program, and $3 billion will fund existing State affordable housing programs.

City staff continue to actively track dozens of housing bills in the State legislature, and are working with the City's lobbyists to give feedback on key legislation. Four active bills that staff is tracking could create investments in affordable housing. Two bills, AB 3171 (Ting) and AB 912 (Beall, Skinner), seek to use a significant portion of the State's surplus for one-time funding of a variety of strategies to address homelessness, including creation of Permanent Supportive Housing. AB 3171 (Ting) would provide $1.5 billion in one-time funding for matching grants to cities to address homelessness. AB 912 (Beall, Skinner) would authorize $2 billion in one-time funding to State programs and to matching grants for cities and counties to address homelessness. SB 918 (Weiner, Rubio) would provide $60 million in annual grants to address youth homelessness.

2. *Increase and Leverage Private, Public, and Nonprofit Investments*
It is essential for our regional economy that workers of all incomes be able to live near their jobs and pay reasonable housing prices. Housing affordability supports both worker retention and creates disposable income that enables people to purchase Silicon Valley's products and services. Major Silicon Valley firms have recently begun to increase their investments in affordable housing. The Housing Trust of Silicon Valley has created The Tech Fund (Tech + Equity + Community + Housing) to provide start-up capital to affordable housing developments. Linkedln recently invested $10 million into the fund, increasing the total amount of investment to $30 million. Cisco announced last month a $50 million commitment to Destination:Home to support the development of permanent supportive housing and ELI housing. And finally, the Chan Zuckenberg Initiative is planning a regional housing fund as a vehicle for private investments. This activity demonstrates that major employers are beginning to invest in affordable housing. Staff's recommendation expands the Mayor's proposal to leverage private dollars to finance not only housing for the "missing middle," but also to finance lower-income affordable housing developments.

Given the City's $125,000 funding cap, affordable housing developers will need to leverage other sources such as those from County Measure A. As the pipeline of affordable housing developments continues to grow, the Housing Department will prioritize funding requests from developers that apply for the State's Affordable Housing and Sustainable Communities Program (AHSC). AHSC is one of the State's largest funding programs and is the most significant State investment in affordable housing since the end of redevelopment. AHSC also can fund cities' much-needed infrastructure improvements close to affordable developments that help to reduce greenhouse gas emissions. For the City's AHSC strategy to work, it is important that the organization devote significant focus and ongoing staff resources to plan and execute AHSC projects.

3. *Consider Local Funding Opportunities*
The Housing Department has published a chart of potential funding sources for affordable housing that have been reviewed in the past by San Jose and other communities. Attachment D provides a brief description of the sources; there are very limited options that do not require voter approval. The Commercial Impact Fee (CIF) is one option that the City Council previously reviewed. In March, 2017 City Council directed staff to explore regional partnerships and study how a regional fee structure or revenue-sharing might address the need. Staff was directed to postpone reconsideration of a potential CIF following completion of deliberations by other cities. On January 12, 2018, staff released an Information Memorandum on the progress of the regional grand nexus study for commercial impact fees. The Housing Department is waiting to find out what action, if any, the City of Milpitas is going to take and will return to the City Council with a final report for further direction. Another option is to negotiate an affordable housing contribution from significant commercial developments that may be planned through a Development Agreement.

Modify Land Use Regulations and Polices to Increase the Supply of Affordable Housing

Land use regulations shape and define what type of housing and where residential development can be built. The City could use its land use authority to develop regulations that support development of more affordable housing. Actions that would facilitate affordable housing development are provided below.

1. *Modify the Affordable General Plan Policies to Make Policies More Effective*
During the last General Plan Four-Year Review in 2016, the City adopted a set of policy modifications and additions that facilitate the development of affordable housing, especially in Urban Villages and in other key Growth Areas. The following two changes were specifically designed to facilitate new affordable development:

   Urban Village Policy IP-5.12
   Residential developments that are 100% affordable to ELI, VLI, and LI households up to 60% AMI can proceed within an Urban Village ahead of a Growth Horizon, or in an Urban Village in a current Horizon that does not have a Council-approved Plan if the development meets defined criteria.

   General Plan Policy H-2.9
   100% deed-restricted affordable housing developments are allowed on sites of 1.5 acres or less, outside of the existing Growth Areas, on properties with Mixed-Use Commercial or Neighborhood/Community Commercial land use designations if the development meets defined criteria.

Affordable housing developers have begun to use these two new policies; however, changes are needed to further the policies' implementation. In addition, changes could be made that would enable affordable developers to better utilize SB 35, the new residential streamlining State law that took effect on January 1, 2018. Proposed changes would permit developers to acquire control of sites with greater certainty. It would also enhance their ability to find sites close to amenities, which is required to be competitive for affordable residential development financing. Proposed modifications include:

a. **Consider allowing mixed-income developments to proceed within an Urban Village ahead of a Growth Horizon.** This change would benefit development of both affordable and market-rate apartments, and fits with other tools that help affordable housing production. State streamlining applies in San Jose for all developments that are at least 50% restricted affordable and meet other defined criteria, so it is possible that the City could already be required to approve some mixed-income developments in Urban Villages in a future horizon. Tax-exempt bond financing, a frequent financing tool for mixed-income affordable developments, requires at least 20% or 40% of units to be affordable, depending on depth of affordability. If the City Council wants to explore this strategy, staff recommends that it be considered during the next Four Year Review of the General Plan scheduled to be initiated in 2019.

b. **Complete a comprehensive review of General Plan Policy H-2.9 and evaluate if streamlining can be applied to affordable housing developments that opt to take advantage of SB 35.** Objective definitions should be adopted to define what "underutilized" and "viability of surrounding commercial properties" means so that developers can take advantage of existing streamlining law and the existing General Plan. Staff recommends that this review begin immediately.

2. *Modify the zoning code to allow 100% affordable developments that are within Urban Villages and are consistent with the applicable village plan, or that meet the criteria of the 1.5-acre rule to build within commercial zoning districts by-right, with a site development permit.*

Affordable housing development is essentially compatible with commercial areas. The zoning code could be amended to enable affordable developments to proceed by-right with a Site Development Permit. Development applications could be approved by the Planning Director and be appealed to the Planning Commission. This change would facilitate more efficient development timeframes, would reduce costs, and would increase development certainty.

3. *Modify the North San Jose Area Development Policy to ensure that affordable housing is developed in Phase II.*

As the North San Jose Area Development Policy moves to Phase II, it will be necessary to develop a strategy to ensure that affordable housing is actually built. Very few affordable housing units were developed in Phase I. Without a strategy, it is likely that the affordable units will not be developed and this will be a lost opportunity.

4. *Consider potential changes to the commercial space requirement for affordable housing developments that meet certain defined parameters.*

   Ground floor commercial and community uses bring jobs, amenities, and street activation to a neighborhood. However, many affordable housing developments are facing challenges filling traditional commercial space because affordable housing financing cannot be used to fund the commercial space. There are three issues that consistently arise with the ground floor commercial requirement for an affordable housing development: 1) Commercial interior spaces sometimes remain unimproved which adds additional risk to the affordable housing development; 2) ground floor commercial space is sometimes difficult to rent once it is completed, and rents derived are frequently low; and 3) ground floor commercial space reduces the number of affordable apartments that can be created which in turn increases per unit subsidy requirements. Housing Department staff would work with staff from both PBCE and OED to consider potential changes to the commercial space requirements for affordable housing.

5. *Complete the revisions to the Accessory Dwelling Units (ADUs) and Garage Conversion Ordinance and develop a program to publicize its use.*

   Consistent with the Mayor's Plan, the City should complete the revisions to code or code interpretations governing ADUs to further encourage their creation. The Housing Department will partner with PBCE and the Housing Trust Silicon Valley to develop a pilot program to increase production of ADUs. In addition, the Housing Department will consider funding fee waivers for ADUs in exchange for enforceable affordability restrictions.

Make it Easier to Acquire Land for Affordable Housing

Finding a suitable site for an affordable housing development is a challenge in San Jose's real estate market. High land prices and competition for sites make it difficult for an affordable developer to acquire land. The lack of viable sites is often identified as a primary obstacle to affordable housing developments. Developing a pipeline of sites will ensure that available funds are deployed as quickly as possible and could help to accelerate the expenditure of Measure A funds.

1. *<u>Establish or Invest in a Land Acquisition Loan Fund</u>*
   The City provides limited funding for land acquisition; however, it is very difficult for City staff to get City Council approval and close land acquisition loans in less than 120 days. There is also a small degree of uncertainty in the City Council approval process. This lead time is too long for affordable housing developers to compete with market-rate developers, who can make cash offers and close in 30 days. City staff only has the authority to approve a predevelopment loan of up to $100,000, $90,000 of which must be secured, without going to

the City Council for approval. The site must also have the appropriate zoning and the environmental review must be completed. Creating or investing in an Acquisition Fund that is nimble and flexible will allow affordable housing developers to compete quickly in today's real estate market. The Acquisition Fund would be used to acquire land and buildings for future affordable housing development.

2. *Identify Underutilized, Small, or Surplus Land in San Jose*
   This recommendation builds on the Mayor's recommendation to better identifying housing sites. The City could identify and map underutilized or surplus publicly owned sites, and small sites that meet the 1.5-acre rule, to facilitate the development of affordable housing.

3. *Explore the Creation of a Land Trust*
   Community land trusts (CLTs) are an established tool that is employed across the country. A CLT is organized to hold land for the benefit of the community and/or individuals. The acquired land can be vacant, residential, or commercial, but the goal is to determine the best use of the land and develop it accordingly. The CLT could work in conjunction with the acquisition fund to acquire and hold land until an affordable housing developer is identified. This reduces the risk and cost of holding the land for the developer. The land trust could hold the land in perpetuity to protect the community investment, and could ensure that ongoing affordability is present in key locations throughout the City. Or, the City could evaluate its capacity to purchase and hold land as an alternative to developing a CLT.

Make it Easier for Developers to Navigate the Development Review Process

As stated earlier in this memorandum, the City used to expedite the development review process for 100% affordable housing developments. While affordable housing was one of several prioritized types of projects, the designation was helpful for developers to get the attention of City staff so that applications could proceed more quickly. If it is the City's priority to produce housing, expedited processing is an option that can help developers get through the development review process as quickly as possible. Alternatives could include:

- Hire dedicated planner(s) for affordable housing developments. The Housing Department has submitted a grant application to support this recommendation.

- Explore creating a locally defined streamlining process for 100% affordable developments that is consistent with SB 35 but meets the City's own priorities and needs. For instance, restricted affordable developments could avoid rezoning and could require only a Site Development Permit approved by the Director of Planning, Building and Code Enforcement, which is appealable to the City Council. The City could adopt the limiting factors of the State SB 35 law, such as the need for streamlining sites to not contain an historic resource or be located near environmentally-sensitive land.

The City of San Jose has a history of establishing ambitious goals to assist its lower-income residents in attaining housing that addresses their needs. Achieving the aggressive affordable housing goals adopted by the City Council will require additional resources, policy changes, and access to land. Without taking additional action, the City will not be able to meet the 10,000 affordable housing goal within the next five years.

PUBLIC OUTREACH

The Housing Department met with affordable housing developers, stakeholders and housing advocates to develop the list of proposed strategies.

EVALUATION AND FOLLOW-UP

After obtaining input from the Community and Economic Development Committee (CEDC), the Housing Department will complete the analysis of potential strategies, coordinating with other departments to create a consolidated recommendation, and bring the proposed AHIP, the NOFA, and the updated Underwriting Policies and Procedures to the City Council by the end of the fiscal year. Once the City Council approves the AHIP, the Housing Department will issue a NOFA and begin accepting applications. The Housing Department will bring forward funding commitments and appropriation approvals for developments that meet the NOFA requirements. The quarterly production report, posted on the City's website, will provide an update on the progress towards meeting the 10,000 unit affordable housing goal.

COST IMPLICATIONS

There are no cost implications associated with the adoption of the Affordable Housing Investment Plan. Funding requests for specific developments will be brought forth individually to City Council for approval.

COORDINATION

This memorandum has been coordinated with the Department of Planning Building and Code Enforcement, the Office of Economic Development, the City Attorney's Office, and the City Manager's Budget Office.

COMMISSION RECOMMENDATION

On January 11, 2018, the Housing Department presented the draft Investment Plan to the Housing and Community Development Commission (HCDC) describing the proposed approach for managing expenditures of affordable housing funds through FY2021/2022. The HCDC unanimously approved the Housing Department's strategy and provided the following feedback:

- Rather than establishing a maximum per unit subsidy, the Housing Department may consider establishing a relative maximum unit subsidy based on a percentage of total development costs for each individual project: and,
- The Housing Department should consider that high-density developments located near transit may necessitate an increase in the maximum per unit subsidy.

HCDC did not review the proposed strategies on how to close the gap in order to reach the 10,000 unit goal.

If the City Council directs staff to explore additional funding sources for affordable housing, to pursue strategies to acquire land for affordable housing, or to work on other policy-related supports for production, staff will bring further details to HCDC for feedback. In addition, staff intends to bring the moderate-income strategy that is being developed to HCDC before presenting to the City Council's Community and Economic Development Committee later in 2018.

CEQA

Not a Project, File No. PP17-008, General Procedure & Policy Making resulting in no changes to the physical environment.

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Jacky Morales-Ferrand, Director, at (408) 535-3855.

Attachments:
Attachment A – Affordable Housing Target Populations
Attachment B – Affordable Housing Production Status Report
Attachment C – City Funding Sources for Affordable Housing
Attachment D – Local Funding Options