CED AGENDA: 5/20/19
ITEM: D (4)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: COMMUNITY & ECONOMIC DEVELOPMENT COMMITTEE

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: May 6, 2019

Approved Kim Walesh

Date May 13, 2019

SUBJECT: MODERATE-INCOME HOUSING STRATEGY UPDATE

RECOMMENDATION

1. Accept the staff report on current strategies to support the creation of housing for moderate-income and other "missing middle" residents in San José; and,

2. Cross-reference this report to the full City Council to be heard at the June 11, 2019, City Council meeting.

EXECUTIVE SUMMARY

This report serves as an update on the various strategies that the Housing Department is pursuing to foster the creation of housing for moderate-income residents in San José. These strategies include studying different financing structures and sources, promoting the production of Accessory Dwelling Units, determining feasibility of a privately funded loan fund, incorporating incentives to build moderate-income housing in North San José, and investigating acquisition/rehabilitation program options. Staff is currently hiring a consultant to provide a report on additional moderate-income housing strategies and recommendations appropriate for San José. Staff intends to return to the City Council for an update and potential further direction after the report is completed in late 2019.

BACKGROUND

City Council Direction

On September 28, 2017, the Mayor issued a memorandum entitled "Responding to the Housing Crisis." This memo identified strategies to address the housing crisis and directed staff to identify which items could be implemented to facilitate the development of 15,000 market-rate and 10,000 affordable residential units by 2022.

On June 6, 2017, the City Council's Community and Economic Development Committee approved the Department's Affordable Housing Investment Plan for FY 2016/17 – 2017/18. As part of that approval, staff was directed to return to the Committee with a moderate-income housing strategy that included policy development options such as: legislation that could facilitate development; encouraging affordability by design; densification in key opportunity development areas; and leveraging private corporate funds.

On June 12, 2018, the City Council approved the Department's Affordable Housing Investment Plan for FY 2017/18 – 2021/22 and the Housing Crisis Response Workplan. The Investment Plan presented the Administration's plan to support the development of affordable housing. Included in the City Council's approval of the Housing Crisis Response Workplan is direction for staff to create a moderate-income housing strategy. The strategy should address "missing middle" housing, including streamlined and innovative approaches to development and financing structures. It should also suggest a framework on the "acquisition of existing older multi-housing stock to preserve as deed-restricted moderate income housing." In addition, the Housing Crisis Response Workplan includes direction for Housing Department staff to work on several initiatives that could facilitate moderate-income housing. These include the following: making additional residential units available in North San José; encouraging private, public, and nonprofit investments in affordable housing; exploring the creation of a Community Land Trust; and leveraging private dollars for "missing middle" housing, among others.

On August 31, 2018, the City issued a $100 million Notice of Funding Availability (NOFA) for affordable housing subsidies. The Information Memorandum issued on February 4, 2019, summarizing results from the NOFA indicates that 5% of the 1,144 new affordable units that could be facilitated by funding awards, would be targeted to households between 61 and 80% AMI. This income group is considered to be within the "missing middle" income range, as explained in the Analysis section below.

Mayor Liccardo's Budget Message of March 8, 2019, directs the City Manager to identify $10 million of Inclusionary Program fee revenue to provide an investment in "missing middle" housing. This expenditure would align with Governor Newsom's January Proposed Budget called for an investment of $500 million for the development of housing for the Missing Middle housing through the expansion of California Housing Finance Agency's (CalHFA) Mixed-Income Loan Program.

On April 9, 2019, the City Council approved an Update to the Department's Affordable Housing Investment Plan. The Updated Investment Plan includes the expenditure of $10 million for "missing middle" housing for residents, per the Mayor's Budget Message.

Table 1 below contains links to several reports listed in this memorandum.

Table 1: Summary of Relevant Reports

Date	Report	Summary
June 6, 2017 (City Council)	FY 2016/17 – 2017/18 Affordable Housing Investment Plan	Investment Plan approval includes direction to return to the Committee with a moderate-income housing strategy that includes policy development options.
September 28, 2017	Mayor's Memo entitled *Responding to the Housing Crisis*	15-point strategy leading to the development of 25,000 homes in five years, of which 10,000 would be affordable
April 23, 2018 (CEDC) June 12, 2018 (City Council)	FY 2017/18 - FY 2021/22 Affordable Housing Investment Plan	Investment Plan identified challenges in meeting the City Council's goal of creating 10,000 affordable homes, and addressed potential funding and other related strategies to try to meet the goal
June 12, 2018 (City Council)	Housing Crisis Response Workplan	Workplan discussed possible means to increase housing production that were identified in both the Mayor's 2017 memo and the Investment Plan
February 25, 2019 (CEDC) March 19, 2018 (City Council)	Housing Crisis Response Workplan Update	Provided an update on the status of implementing the action items identified in the Housing Crisis Response Workplan
March 8, 2019	Mayor's Budget Message	Directed Housing Department staff to return during the budget process with a cost estimate for the creation of an affordable housing fund leveraging private investment for "missing middle" housing
March 25, 2019 (CEDC) April 9, 2019 (City Council)	Update to the Affordable Housing Investment Plan	Approved the use of $10 million for "missing middle" housing

Clarifying Definitions and Focus on Moderate-income Housing

As noted above, the original direction from the City Council was to investigate "moderate-income" housing strategies. "Moderate-income" housing is defined under the California Health and Safety Code as serving households with incomes in the range of 81% to 120% of Area Median Income (AMI). Per the current income limits that the State issued in 2018 for Santa Clara County, which depend on family size, a moderate-income three-person family would earn between $85,050 and $135,250 per year. A single person as of 2018 would be considered to be moderate-income if they earned between $66,150 and $105,200 per year. See Table 2 below for the current maximum incomes for each category in Santa Clara County, issued by the State of California.

***Table 2: 2018 Income Limits for Santa Clara County*[1]**

INCOME CATEGORY	NUMBER OF PERSONS IN HOUSEHOLD							
	1	2	3	4	5	6	7	8
Extremely Low-Income	27,950	31,950	35,950	39,900	43,100	46,300	49,500	52,700
Very Low-Income	46,550	53,200	59,850	66,500	71,850	77,150	82,500	87,800
Low-Income	**66,150**	**75,600**	**85,050**	**94,450**	**102,050**	**109,600**	**117,150**	**124,700**
Moderate-Income	**105,200**	**120,200**	**135,250**	**150,250**	**162,250**	**174,300**	**186,300**	**198,350**

***Source**: California Department of Housing and Community Development, 2018 and Source: California Employment Development Department, 2018.*

Several of the City Council's more recent motions direct staff to determine how to serve the "missing middle." There is no standard definition for "missing middle," although it generally means households that make a decent income but still are stretched to afford high housing costs. Based on staff's research, this label can refer to anyone making from 61% AMI to 150% AMI, depending on the circumstances and the cost of the local housing market.

Many low-income residents with incomes in the 61-80% AMI range struggle daily to afford housing in our expensive market. As an example, this would include families of three people with total income between $71,820 and $85,050 in 2018. However, the income range served by the vast majority of the City's existing restricted affordable apartments is 60% AMI and below. Recent changes to tax credit regulations at the federal level and in California allow new developments to serve residents between 61% and 80% AMI so long as the average affordability does not exceed 50% AMI. In the near-term, there will be a small percentage of new apartments targeting this income group.

Further, some strategies that could be appropriate to house moderate-income people could also help those at slightly higher incomes. The range of incomes at 121-150% AMI is commonly referred to as "middle income." In 2018, a three-person household in the middle-income range would have earned between $135,250 and $169,050. None of the affordable apartments that the City oversees serve middle-income residents, as the privately-financed housing market generally serves this income group.

The City Council's original direction to staff was to focus on moderate-income housing; accordingly, staff's work has focused on advancing for residents in this group who earn 81 to 120% AMI. In the current reporting cycle, the City's achievements in the State's Regional

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[1] **Note**: Bolded rows indicate the Moderate-income range; bold outlines indicate high and low incomes for the entire Moderate-income range at different household sizes. For example, a one-person household that earns more than $66,150 but less than $105,200 is considered to be at a Moderate-income level.

Housing Needs Allocation (RHNA) for this income group have been quite low. There are very few housing tools currently to meet the needs of these residents. Therefore, moderate-income housing is the focus of this report, while the rest of the "missing middle" is also addressed as appropriate.

Moderate-income Residents and Housing in San José

A large proportion of San Jose's population qualifies as moderate-income. Census data estimates that 65,354 households in San Jose qualify as moderate-income. This constitutes approximately 20% of all households in the City.[2]

Selected jobs that pay moderate-income wages are indicated in **Attachment A**. The vertical dotted lines indicate the boundaries of moderate-income wage rates, according to household size (one to eight people). Jobs that pay in this range include teachers, mechanics, social workers, accountants, registered nurses, and computer hardware engineers.

Historically, the City has invested the majority of its funds available for affordable housing to provide deed-restricted rental housing for low, very low, and extremely low-income housing. The primary funding source for the creation of this deed-restricted housing was redevelopment tax-increment funds designated for affordable housing. Prior to redevelopment dissolution in 2012, the City also operated a very successful homebuyer down payment assistance programs for low- and moderate-income households. This included a homebuyer program for teachers and public school employees, funded by redevelopment funds, as well as pass-throughs of State BEGIN and CalHOME funding awards for down payment assistance. Since the elimination of redevelopment, both the City's strategies and the State's redevelopment program income reuse rules have supported an even greater emphasis on using limited resources for people with the greatest need; therefore, the Housing Department is no longer allowed to use any of its repayments of redevelopment-funded loans for moderate-income housing. As noted in the Affordable Housing Investment Plan, the Department has extremely limited funds for this income group.

During the 1990s and early/mid-2000s, the local housing market was able to produce moderate-income housing with little, if any, financial subsidy from the City. For new construction apartments, some developers produced apartments under the City's inclusionary housing program with no City subsidy. Many inclusionary rental developments continue to offer rents for households with incomes up to 50% and up to 60% AMI. Rental housing opportunities for low and moderate-income housing used to be funded with 4% tax credit investments combined with tax-exempt multifamily housing revenue bond financing. City subsidies were not needed for these "bonds and tax credits only" projects that focused on acquisition and rehabilitation of existing apartment complexes. Tax-exempt bonds require only a portion of apartments to be income-restricted, while the rest of the apartments can charge market-rate rents. During that

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[2] American Community Survey One-year Estimates for San Jose, 2017.

time, market-rate rents were affordable to renters with incomes from low-income to moderate-income levels.

San José's current for-sale home prices[3] require a hefty subsidy to enable moderate-income households to purchase a home. The current estimated gap to bring a median priced market-rate condominium or townhouse of $776,000 to be affordable to a 120% AMI buyer priced at the highest level allowable – 110% AMI – produces a gap of approximately $320,500.[4] For the median-priced single family detached home of $1,125,000, the gap is much larger – approximately $729,200. These conditions make it cost-prohibitive for the City to run traditional homebuyer down payment assistance programs that were previously funded annually with several million dollars in redevelopment funds, at much lower subsidy levels per household.

ANALYSIS

Since the City Council's original requests to examine how to improve the City's provision of moderate-income homes, staff has worked on several initiatives to foster moderate-income housing in our high-cost market.

At the same time, staff will monitor how many low-income households between 61% and 80% AMI are served by various existing affordable housing strategies. These include new tax credit-funded developments that the City subsidizes, and apartments that could be created per the City's Inclusionary Housing Ordinance. As these households at 61-80% AMI have fewer resources than those at moderate-income levels, and as they are not served by the vast majority of the City's restricted affordable apartments, they also deserve additional staff focus. However, low-income households between 51% and 60% AMI *are* served regularly by tax-credit financed developments; therefore, the City's low-income (51-80% AMI) RHNA achievement is better than for the moderate-income range.

Updates on staff's progress on the various strategies for moderate-income housing are as follows.

Improved Regional Housing Needs Allocation Counting Methodology

In early 2018, staff developed and used a new methodology to count moderate-income housing units for purposes of annual reporting to the State on the City's Regional Housing Needs Allocation (RHNA) count. The State's guidance on RHNA for this level of affordability does not require recorded affordability restrictions, but does allow cities to count homes that meet the affordable housing cost definition for moderate-income (priced at or below costs based on 110% AMI household assuming a 30% payment standard.) Staff's methodology involves trended estimates on rents in the zip code for which building permits are issued during the calendar year

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[3] Santa Clara Association of Realtors data, Mar. 2019, https://www.sccaor.com/housing-stats/.

[4] Calculations as of 04/30/2019 assume 30-year Freddie Mac fixed-rate mortgage rate of 4.20%, PMI of 85 bps, 35% housing cost ratio, and $1,772 total cost for non-PITI monthly expenses (taxes, insurance, HOA, maintenance, etc.).

in order to estimate whether the likely rents of a forthcoming building's apartments is in the moderate-income range. Using this revised methodology, the City's report on its 2018 Housing Element to the State[5] identified 1,300 apartments that were counted as affordable to moderate-income households based upon market conditions. However, it should be noted these are estimates. In addition, it is uncertain how long the homes would remain affordable to moderate-income households because of the lack of affordability restrictions that require that homes remain affordable over time. Staff will review the actual rents when the developments begin leasing to validate the methodology.

The private market has been able to produce some moderate-income units; however, development of these units needs to be accelerated. Developers have pulled building permits for an estimated 1,585 homes to serve moderate-income residents since 2014. This is less than half of the production level (3,515) that should have been achieved as of the end of 2018, and is 26% of the City's total goal of 6,188 moderate-income homes to achieve by 2022. The City's remaining moderate-income housing goal is therefore 4,603 homes to achieve in the four years remaining in the current RHNA cycle, or an average of 1,151 units per year.

Challenges in Financing Moderate-income Affordable Apartments

While the current average rent for apartments of all ages in the San José market is in the moderate-income range,[6] new Class A apartments in Downtown and North San José are coming on-line priced well above the City's median rent level. Construction costs have risen significantly over the past few years in the Bay Area.[7] Therefore, apartment buildings now under construction in San José likely have lower development costs than projected for developments now in their predevelopment phase that have not yet been built. This indicates that apartment developments that have not yet started construction will likely need to get higher rents in order to cover their higher costs, as long as sufficient demand for units exists at those higher rents.

There are three clear financial challenges in producing moderate-income apartments that are different than for more deeply-affordable apartments. First, federal and state low-income housing tax credits create incentives for investors to put equity into apartments for residents at or below 80% AMI. However, there are no analogous federal or state tax credits to support the creation of moderately-affordable units. This leaves moderate-income housing developments out of the tax credit equity investor market. The supply of tax credit equity to enable affordability is very important, as it contributes perhaps 20-25% of projects' total development costs. It also

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[5] https://sanjose.legistar.com/LegislationDetail.aspx?ID=3877385&GUID=0B4E7599-789B-4B74-AD73-54ED03CC3DE5.

[6] City of San José Housing Department, *San José Housing Market Update Q4 2018*, p.2 (median rent for 2BR $2,674 requires salary of $106,960/year for presumed household of three at approximately 95% AMI), http://www.sanjoseca.gov/DocumentCenter/View/83420.

[7] Hansen, Louis, "New Bay Area crown: Most expensive place in the world to build," *Mercury News*, Apr 25., 2019, https://www.mercurynews.com/2019/04/25/new-bay-area-crown-most-expensive-place-to-build-in-the-world/.

typically requires lower rates of return than for private equity invested in market-rate developments.
Second, few sources of City funding for affordable housing can be used for moderate-income housing.[8] City funding also brings prevailing wage requirements in San Jose, which can add to development costs. For these reasons, it would be difficult for the City to subsidize significant production of moderate-income housing.

Third, while the State's welfare tax exemption exempts low-income apartments at or below 80% AMI from property tax if certain conditions are met, no such exemption currently for moderate-income apartments. The resulting increase in operating costs therefore requires higher rents in order to cover costs. State legislation has been introduced for the past two sessions that would create a property tax exemption for moderate-income apartments. The current bill, AB 1734 (Chiu et al., 2019)[9], would reduce taxes on moderate-income apartments with state or local funding only if their rents remain well below market and if other conditions are met. The bill currently features a five-year sunset provision. The downside of this type of legislation is that it would reduce the near-term property tax collected in the County, therefore reducing the City's revenues.

Staff could do further research on the potential cost to the City of this real estate tax exemption for moderate-income apartments if the City Council were interested in this legislation.

Investigation Continues into a Moderate-income Debt Fund and Other Financing Products

Given the challenges explained above, and given City Council's direction, staff engaged consulting help from David Rosen and Associates (DRA) in 2018. DRA's analysis[10] (**Attachment B**) has focused on how to incent forthcoming market-rate housing production in San José to include a small percentage of moderately-priced restricted affordable apartments. The consultant's assumptions for development costs, types of buildings, and submarket rents are consistent with those presented in late 2018 to the City Council in the Cost of Residential Development. Given these assumptions, which were further refined in early 2019, DRA's financial and market analysis indicates that the use of reasonable-cost mezzanine financing could potentially incent these units to be created for developers who use outside financing sources. The mezzanine loans would be in second position behind short-term construction financing. A fund could be created, to be capitalized with private investors' funds, while the City's role, if any, would be limited and would not include providing capital for development. Further analysis on the structure of a potential fund and other alternatives would be required and is ongoing.

To support this work in the near-term, staff will provide information as directed in the Mayor's Budget Message to include cost estimates for next steps in investigating a potential fund. Further

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[8] Affordable Housing Investment Plan Update, https://sanjose.legistar.com/LegislationDetail.aspx?ID=3898363&GUID=D44B3214-4A39-4671-AC57-025450DF0794.
[9] AB 1734, http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB1734.
[10] David Rosen & Associates, *Moderate-income Housing Fund for San José revised findings,* Jan. 17, 2019.

development of this fund, or an alternative, would also need legal review by outside counsel with expertise in securities regulations and additional analysis. Those additional legal costs could be requested in the future if next steps analysis proved to be promising.

Production of Accessory Dwelling Units is Rising

Accessory Dwelling Units (ADUs) are known by several names, including "secondary units", "in-law units" and "granny flats." They consist of a standalone or attached small home built in single family areas. They range in size from a studio to two-bedroom units. ADUs are thought to be an alternative type of housing that can provide moderate-cost housing opportunities. They are a particularly appropriate type of production for a City like San José, with a large single family housing stock.

Accordingly, the City has made several positive changes in the past 2.5 years to encourage the production of ADUs. In November 2016, the City Council approved amendments to the City's Secondary Unit code[11] which loosened existing zoning regulations and incorporated changes made to State law in 2016. Staff from the Department of Planning, Building and Code Enforcement also created a dedicated webpage for ADUs and simplified the process to apply for building permits. Due to these local efforts and to State law changes, San José's ADU production has been increasing significantly. The City issued 21 ADU permits in 2014 and 17 ADU permits in 2015. But in 2016, the number increased to 38 ADUs despite changes to zoning code being made at the end of the year, which almost doubled the annual rate of permits issued in the previous two years. In 2017, 92 ADU building permits were issued, while 190 ADU building permits were issued in 2018.[12] The 2018 permitting rate was nine times as great as that in 2014, indicating the positive impact from recent changes to promote the production of ADUs.

It is likely that a portion of ADUs will be priced by private owners as affordable to moderate-income households. This likelihood is supported by rent studies on ADUs in the Bay Area and other cities.[13] Staff from the Housing Department and Planning, Building and Code Enforcement plan to implement a way to collect initial rents data when owners pull building permits for their ADUs. Once rents are collected, staff will accordingly reflect those ADUs that qualify as moderate-income units for the RHNA count. Further, the Housing Department has agreed to help Planning, Building and Code Enforcement to fund a video to further assist homeowners considering ADU construction.

Finally, City staff is working very closely with the Housing Trust of Silicon Valley to try to spur the production of ADUs. Staff from Planning, Building and Code Enforcement regularly teams with Housing Trust staff to hold homeowner outreach events for those interested in building ADUs. City staff shares information on what types of units are possible to build, how to go

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[11] Section 20.30.150 of the City's Municipal Code.

[12] *San José Housing Market Update Q4 2018*, p.5, http://www.sanjoseca.gov/DocumentCenter/View/83420.

[13] Garcia, David, *ADU Update: Early Lessons and Impacts of California's State and Local Policy Changes* (Dec. 2017), p. 2; Chapple, Karen et al., *Jumpstarting the Market for Accessory Dwelling Units* (2017) p.18; 21 Elements, *Affordability of Accessory Dwelling Units* (Apr. 9, 2014).

through San José's permitting process, and what San José's regulations permit. The Housing Trust has also helped to compile cost data for staff. This data has helped to inform both the City's strategies and its analysis of legislation that could potentially affect local governments' ability to charge fees for ADUs.

The Housing Trust also is in the process of finalizing an ADU construction loan product that would enable homeowners to borrow funds to build ADUs. The loan is designed to be refinanced by a traditional commercial mortgage after three years, and it is more flexible than conventional loans in allowing ADU rents to be underwritten. The loan would carry an affordability requirement for an ADU's tenant for at least the term of the loan, for which the Housing Trust would administer compliance. Housing staff is working actively with the Housing Trust to create a companion grant that complements the Housing Trust's financing product in order to financially incent homeowners to rent to moderate-income households starting in FY 2019-20.

Affordable Housing Production in North San José Could Include Moderate-income Homes

Housing Department staff have collaborated closely with the Office of Economic Development, Department of Planning, Building and Code Enforcement, and the Department of Transportation to identify ways to incent developers to produce affordable homes as the City anticipates opening the next allocation of 8,000 housing units in North San José. The update to the North San José Area Development Policy also requires clarification of affordability levels in the Policy's stated goal of at least 20% of all housing built in North San José to be restricted affordable homes. Staff is analyzing whether and how some "missing middle" housing could be produced through incentives to build new affordable rental and for-sale homes in that area after the housing allocation is released. The housing release is anticipated to occur in the next six months, and further details are expected to come to the City Council in mid-2019.

Alternative Financing Structures and Partnerships Are Possible

Senior staff from several departments have been involved with evaluating the potential for City-owned and State-owned sites to be reimagined and redeveloped into denser mixed-use forms that incorporate some housing. It is possible that moderate-income housing could be produced as part of these redevelopments, which would likely involve public/private partnerships that involve private debt and equity, and potentially the City's issuance of certain types of public purpose bonds.

Further, Housing staff has met with other cities, CalHFA, Freddie Mac, and municipal finance professionals to discuss different financing structures for new construction that include some moderate-income apartments. Some of these structures involve City funding and/or City issuance of tax-exempt bonds. Senior loan products, such as those from Freddie Mac and CalHFA, may or may not require some subsidy from the City or City bond issuance. Staff is examining pros and cons of different structures. If any prove to be promising, and/or are identified by the City's consultant, Housing staff will investigate further together with other departments' staff and external counsel, if appropriate. Staff also may elect to convene local market-rate and affordable housing developers to educate them and to gauge their interest.

Investigating Community Land Trusts and Shared Equity Housing Models

In Spring 2019, Housing staff participated in a convening hosted by the Silicon Valley Community Foundation that focused on different ways to help promote housing security for South Bay residents at a range of incomes. Some of the dozens of strategies discussed included community land trusts, shared equity models of homeownership, and ways in which community groups could be notified and potentially form organizations to purchase apartment buildings in order to help stabilize neighborhoods. This convening added to staff's ongoing research of the necessary ingredients to success in establishing a financially viable community land trust. Staff has asked for consulting assistance (explained below) to further identify potentially viable strategies such as these.

Acquisition / Rehabilitation of Existing Apartments

In the City Council's direction through Housing Crisis Response Workplan, Housing Department staff is currently analyzing an acquisition/rehabilitation strategy. In the City Council's April 2019 approval of the Housing Department's Update to the Affordable Housing Investment Plan, it confirmed that up to $10 million of the Department's limited resources should be used for acquisition/rehabilitation strategy. Acquisition and rehabilitation of existing market-rate properties that may be naturally affordable has been shown to help stabilize renters, decrease their potential for displacement, and create additional long-term restricted affordability. According to developers and staff from cities that regularly fund acquisition/rehabilitation, some existing residents of these buildings may fall in the "missing middle" income range. In an effort to avoid displacement of residents from their homes, sources of City financing need to be able to accommodate moderate-income households.

Staff is currently looking at several options for acquisition/rehabilitation programs, although more may surface. First, staff could potentially use these funds to fund the acquisition/ rehabilitation of what would be a typical tax credit project of 50 to 125 apartments. While underwriting standards differ for this use from those used in the City's new construction NOFA, they are similar. A second option would involve focusing on higher numbers of smaller buildings with mission-oriented developers who may want to focus in certain neighborhoods. Enterprise Communities, a national nonprofit intermediary, is facilitating information sharing among Bay Area localities using this strategy, which include San Francisco, Oakland, and San Mateo County. Both of these strategies require significant City funding for what could potentially be moderate-income apartments, based on existing residents' incomes. Localities that are actively employing these strategies may use funds from inclusionary housing in-lieu fees, but more commonly use funds from general obligation bonds for affordable housing, which provide the needed flexibility.

A third possible option involves an innovative structure involving a bond issuance through a joint powers authority with the City as a member, and a City-related entity would have the option to assume ownership of the development at a predetermined time if it so desires. Staff from Housing and Finance Departments, the City Attorney's Office, and external advisors have met twice with developers and counsel to explore on this potential idea, which was recently used with the City of Santa Rosa. Staff is continuing these conversations. Residents at a broad range of incomes – including moderate-income – could potentially be served with this structure.

Housing staff expects to bring to the City Council its recommendations on acquisition/ rehabilitation funding and potential program(s) later in 2019.

Moderate-income Consultant Report is Underway

In April 2019, the Housing Department issued a Request for Proposals for a consultant to research and provide the City with a report outlining informed options on how to best address the housing needs of San José's moderate-income families in a manner that makes the best use of extremely limited public resources. In achieving this objective, the selected consultant will analyze San José-specific data, consider the City's ongoing work, review recent and forthcoming reports (such as those from the Milliken Institute, SV@Home, and Grounded Solutions), and review other cities' best practices. Strategies to be examined include land use entitlements and physical dwelling types, financing products and structures, and different programs and policies that can help result in housing for moderate-income households. In addition, the consultant scope includes analysis as to whether 'naturally affordable' housing remains affordable over the medium- to long-term, and what types of programs could help middle-income households (121-150% AMI) to obtain affordable housing.

The goal is for staff to return with findings from the consultant, and potential recommendations on other "missing middle" housing strategies, to the City Council in late 2019.

Conclusion

Staff proposes to continue its focus on identifying strategies to serve moderate-income households (81-120% AMI). The City is obligated to serve this income group through its RHNA goals, and it is included in the definition of affordable housing in State law. The City's previous support of this income group was through homebuyer programs, which the City no longer offers. There are few existing affordable housing tools to serve this income group, which is why it requires staff's focus.

In addition, staff will be tracking new housing opportunities being created for the lower end of the "missing middle" group. Staff will follow how many low-income households between 61% and 80% AMI will be served by new tax credit-funded developments that the City subsidizes, and by apartments that could be created by the City's Inclusionary Housing Ordinance. As these households have fewer resources than those at moderate-income levels, and they are not served by the vast majority of the City's restricted affordable apartments, they also deserve additional staff focus.

PUBLIC OUTREACH

A memo on the Moderate-income Housing Strategy Update will be reviewed and discussed at the public meeting of the San José Housing and Community Development Commission on May 9, 2019. Additionally, this memo was posted to the May 20, 2019, agenda for the Community and Economic Development Committee.

EVALUATION AND FOLLOW-UP

While significant staff work has continued in the past months since the moderate-income strategy became part of the Housing Crisis Response Workplan, there remains much work to do on increasing production of restricted affordable housing for moderate-income residents. Staff had hoped to have the results of a consultant to report back with newly-identified strategies for this report to CEDC; however, procurement of the consultant was delayed due to other pressing priorities but is now proceeding. Therefore, staff intends to return to CEDC and to the City Council in late 2019 with a follow-up report based on the consultant's report.

COORDINATION

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

FISCAL/POLICY ALIGNMENT

The creation of moderate-income housing options is consistent with the City's obligation under its State-certified Housing Element to meet its Regional Housing Needs Allocation production goals for affordable housing, including that for moderate-income households. It is also consistent with the City Council's approval of the Housing Crisis Response Workplan and its Update to the Affordable Housing Investment Plan.

COST SUMMARY/IMPLICATIONS

Costs for the alternative dwelling unit video coordinated with Planning, Building and Code Enforcement will be absorbed in the Housing Non-Personal/Equipment appropriation. Appropriation actions for the Moderate-income consulting report will be brought forward after the Request for Proposal is complete and cost can be determined. Eligible sources for costs associated with setting up a Moderate-income housing fund using reasonable cost mezzanine financing are limited, potentially requiring resources from the General Fund. The feasibility of a Moderate-income housing fund is being evaluated and associated costs – and funding source eligibility – will be presented to City Council in a Manager's Budget Addendum by May 24, 2019.

COMMISSION RECOMMENDATION/INPUT

The Housing and Community Development Commission will receive this update at its May 9, 2019, meeting. Any specific recommendations will be summarized in a supplemental report to this memorandum.

CEQA

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

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Kristen Clements, Division Manager, at (408) 535-8236.

Attachments:
Attachment A – Mean Annual Wages for Moderate-income Jobs in San Jose-Sunnyvale-Santa Clara 2018
Attachment B – David Rosen & Associates, *Memorandum: Moderate-income Housing Fund for San José revised findings,* Jan. 17, 2019.