TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

DATE: June 12, 2019

SUBJECT: MODERATE-INCOME HOUSING STRATEGY UPDATE INCLUDING A FORGIVABLE LOAN PROGRAM TO INCENTIVIZE HOMEOWNERS TO BUILD ACCESSORY DWELLING UNITS

RECOMMENDATION

(a) Accept the staff report referred by the Community and Economic Development Committee on current strategies to support the creation of housing for moderate-income and other “missing middle” residents in San José.

(b) Accept this staff report which updates information contained in the original staff memo, provides information on homebuyer downpayment programs, and addresses components of the memorandum from Mayor Liccardo and Councilmembers Carrasco, Arenas and Foley entitled “Yes, In My Back Yard (YIMBY) Affordable Housing Program” dated May 14, 2019, and approved by the Rules and Open Government Committee on May 22, 2019, for full City Council consideration.

(c) Provide direction to staff to:

(1) Include within the scope of negotiations with the Housing Trust of Silicon Valley (Housing Trust) the development of loans to facilitate construction of Accessory Dwelling Units (ADUs) which are forgivable upon rental of the ADU at affordable rents for a period of time; and

(2) Coordinate with the Parks, Recreation and Neighborhood Department regarding a potential fee waiver for ADUs.
OUTCOME

The Housing Department will continue to research potential strategies and will complete a moderate-income housing strategy. Approval of the recommendations will result in the staff developing a loan product, with the Housing Trust, to support the production of ADUs for moderate-income households.

BACKGROUND

This memorandum has four purposes. It provides: 1) updated information on 2019 income limits, which defines which households are considered to be moderate-income in San José; 2) additional information on a potential financing strategy based on the City’s approval of membership in a joint powers authority and that entity’s issuance of bonds mentioned in the original staff memorandum; 3) information on downpayment assistance programs and available resources to support a new program; and 4) staff’s responses to the YIMBY memorandum of May 14, 2019, regarding support strategies for ADU production.

ANALYSIS

2019 Income Limits

Table A reflects updated income limits for 2019. These limits were recently issued by the State of California. The bolded row indicates the range for moderate-income households of one to eight people. Note Santa Clara County’s moderate-income limits rose approximately 5% over those from 2018.

Table A: 2019 Income Limits for Santa Clara County

<table>
<thead>
<tr>
<th>INCOME CATEGORY</th>
<th>MAXIMUM INCOMES FOR NUMBER OF PERSONS IN HOUSEHOLD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Extremely Low-Income</td>
<td>30,750</td>
</tr>
<tr>
<td>Very Low-Income</td>
<td>51,250</td>
</tr>
<tr>
<td>Low-Income</td>
<td>72,750</td>
</tr>
<tr>
<td>Moderate-Income</td>
<td>110,400</td>
</tr>
</tbody>
</table>

Source: California Department of Housing and Community Development, 2019.

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 $72,750 but less than $110,400 is considered to be at a Moderate-income level.
Joint Powers Authority Bond Issuance Structure

Staff’s May 2019 memorandum to Community and Economic Development Committee (CEDC) describes a financial structure that could be used for the construction or the acquisition and rehabilitation of existing buildings. The structure involves the issuance of bonds by a joint powers authority that could potentially result in restricted affordable apartments at a range of income levels, including moderate-income, without the need for City funds. Staff recently received additional information on this structure and how it was deployed in the City of Santa Rosa. For that transaction, the joint powers authority issued bonds to support the new construction of a Class A apartment building that was income restricted to low- and moderate-income residents. It also capped rent increases at 4% per year, a level specific to that transaction. The structure offers the advantage of future property ownership to the City, or to a related entity, in return for the assumption of existing debt, if any, and no capital outlay through the exercise of an option to purchase during a range of years.

Staff from the Housing and Finance Departments, the City Attorney’s Office, and external advisors will continue to explore this potentially promising structure to see if it could work in San José and is appropriate for the City’s involvement.

Homeownership Downpayment Assistance Programs

The City has managed a number of homeownership programs over time funded by a variety of different funding sources. Combined, these programs have assisted over 1,200 households in purchasing their first home. The following are examples of programs managed by the Housing Department:

- Inclusionary Housing Policy – The former redevelopment law required that 15% of all new ownership housing developed be made affordable to moderate-income homebuyers. Developers funded a deferred loan to the buyer with an equity share term paid backed to the City at the time of sale. A total of 418 homes were sold to moderate-income buyers.
- Teacher Homebuyer Program – This program provided downpayment assistance to 740 public school teachers in San José with an equity share payment due to the City upon the sale of the property. This program was funded with 20% Low and Moderate Income Housing funds, which State legislation no longer allows for moderate-income housing.
- Welcome Home Program – This program provided downpayment assistance to qualified homebuyers and was funded by the City’s federal HOME funds. HOME funds are currently used to provide rental assistance subsidies for formally homeless households and to fund the construction of new affordable housing development.
- CalHome Homebuyer Program – This State funded program provided low interest deferred loans to qualified homebuyers earning up to 80% of the area median income (AMI). The funds have been challenging to spend for first-time homebuyer loans because of the cost of housing in San José.
• BEGIN – This was a State funded downpayment assistance program, targeting households earning up to 120% of the AMI, tied to a specific multifamily homeownership development. This program is not currently being funded by the State.

• NSP2 Program – This was a homeownership program used to assist homebuyers in purchasing foreclosed homes. The program was a competitive federal grant program that is no longer available. A total of 53 homes were acquired, rehabilitated, and sold to qualified first-time homebuyers.

Following the loss of redevelopment and the scarcity of State funds, the Housing Department began developing one-year investment plans to obtain City Council direction on how to allocate its scarce resources. On May 22, 2017, the CEDC approved the FY2016/17 – FY2017/18 Affordable Housing Investment Plan (Investment Plan). The Investment Plan prioritized completing funding commitments for developments already identified for permanent supportive housing. The Investment Plan also proposed that moderate-income housing programs, including homeownership, would be fully explored in the Moderate-Income Housing Strategy.

Over time, the Housing Department has accumulated funds through the repayment of homebuyer loans previously funded by State programs. The use of the funds is limited to either providing downpayment assistance loans or funding a rehabilitation loan program for owner-occupied homes. In addition, the Housing Impact Fee has a set-aside intended to assist with home ownership for moderate-income households. The current balance of these funds adds up to $6.6 million available for funding homeownership programs.

Table B: Available Funds for Homeownership

<table>
<thead>
<tr>
<th>Funding Source</th>
<th>Income Limit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalHome</td>
<td>80% of the AMI</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>BEGIN</td>
<td>120% of the AMI</td>
<td>$4,400,000</td>
</tr>
<tr>
<td>14% of Affordable Housing Impact Fees</td>
<td>120% of the AMI</td>
<td>$229,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>$6,629,000</strong></td>
</tr>
</tbody>
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The current for-sale housing market in San José creates challenges for creating a homeownership program benefiting moderate income households. Typically, a homeownership program is designed to provide the “gap” financing needed to allow a moderate-income household to commit 35% of their income to a mortgage for a home. These gaps range between $100K and $550K depending on the home price and household income level.
Table C: Amount of Downpayment Needed to Meet Different Income Levels

<table>
<thead>
<tr>
<th>Sales Prices</th>
<th>$600,000</th>
<th>$700,000</th>
<th>$800,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>70% of AMI</td>
<td>$319,000</td>
<td>$437,000</td>
<td>$553,000</td>
</tr>
<tr>
<td>110% of AMI</td>
<td>$102,000</td>
<td>$156,000</td>
<td>$274,000</td>
</tr>
<tr>
<td># monthly sales</td>
<td>38</td>
<td>40</td>
<td>63</td>
</tr>
</tbody>
</table>

Assumptions:
- $400 HOA dues
- 1st Mtg. rates of 4.10%
- 2-persons/3-bedroom
- 35% housing ratio
- 3% downpayment by borrower
- 1.125% for property taxes

A strategy used to narrow this gap is to layer subsidy programs together to meet the need. The County of Santa Clara (the County) has invested $25 million of Measure A funds to create the Empower Homebuyers program throughout Santa Clara County. The County conducted a competitive process and selected the Housing Trust of Silicon Valley (Housing Trust) to manage and design the program. The Empower Homebuyers program provides downpayment assistance loans to first-time homebuyers up to 120% of the AMI. The maximum loan amount is 17% of the purchase price; the maximum purchase price is $800,000. Exploring options with the County to layer resources may allow for the assistance of more homebuyers through a homeownership program, or allow for more households at lower incomes to purchase a home, and would lower the gap payment that the City would need to fund. This is one strategy that may allow a viable solution to assisting moderate-income households in a challenging market. One challenge that would need to be resolved is the States requirement of their deed of trust to be recorded in the second position after the first mortgage loan. The County loan currently has the same requirement.

Accessory Dwelling Units

On May 14, 2019, Mayor Liccardo and Councilmembers Carrasco, Arenas and Foley wrote a memo entitled “Yes, In My Back Yard (YIMBY) Affordable Housing Program,” (YIMBY memo) which proposes several initiatives to spur the production of ADUs. The YIMBY memo was approved at the Rules and Open Government Committee (Rules) on May 22, 2019, and is to be heard by the City Council in conjunction with this Moderate-income Strategy Update.

In response to the YIMBY memo, staff submitted a response green-lighting the work on a loan product (YIMBY memo item 1). It confirmed that the Housing Department has already had discussions with the Housing Trust on the development of a forgivable loan program to support the development of ADUs in return for affordable ADU rent for a period of time. Staff started these discussions as a result of previous direction from the City Council. The original direction
was contained in the YIMBY memorandum on the housing crisis that went to Rules on October 4, 2017, and was later prioritized through the City Council priority-setting. These work items formed the basis of the Housing Crisis Workplan that the City Council approved in June 2018. The original directions from 2017 were for staff to work together with the Housing Trust to support its pilot ADU program, and to discuss with the Housing Trust possible financing mechanisms for affordable “missing middle” housing. Staff discontinued these discussions to fund a companion loan program when Measure V failed. Staff has reinitiated discussions with the Housing Trust in response to the YIMBY memo.

The YIMBY memo item 2 recommends waiving all City impact fees for ADUs or converted garages participating in this program in return for affordability. The Director of Housing is coordinating with the Parks, Recreation and Neighborhood Department (PRNS) and will report back on a potential fee waiver when this item returns to the City Council in August.

Staff has discussed with the Housing Trust draft product parameters consistent with terms contained in the YIMBY memo item 3, including: ADUs receiving loans will be rented to low-to moderate-income tenants at restricted rents; loans will be forgiven over time if they remain compliant with requirements; and loans are anticipated to be at a set amount, such as $20,000 to be used for city fees, predevelopment, and construction costs of ADUs.

Item 4 in the YIMBY memo addresses concerns of funding sources eligible for this ADU product. Recommendation 4a in the YIMBY memo is to evaluate up to $5 million from the City’s Low-Moderate Income/Multi-Source Housing Funds for this use. The City’s Low and Moderate Income Housing Asset Fund is restricted to use for housing affordable to households at or below 80% of AMI (low-income), and rental units must be deed-restricted for at least 55 years. Similar restrictions apply to most of the funds managed by the Housing Department. Staff will: 1) return with a request for allocation for the proposed program and appropriate funding source; 2) conduct additional research about any potential State sources of funding to support this program as they emerge through the current budget cycle (YIMBY memo item 4b); and 3) discuss with the Housing Trust the potential to attract additional private funding partners to leverage our collective funds (YIMBY memo item 4c).

Housing Department staff plans to return to the City Council in August with proposed loan program details and an appropriation request. At that time, staff from the Department of Planning, Building and Code Enforcement (PBCE) will also plan to give an update on obstacles to permitting ADUs and potential solutions. (YIMBY memo item 5).

Note that Administration does not have capacity at this time to undertake item 6 (facilitating and incenting garage conversions), and item 7 (work on showcasing producers and financing sources for ADUs) in the YIMBY memo.
PUBLIC OUTREACH

A memo on the broad Moderate-income Housing Strategy Update was discussed at the public meeting of the San José Housing and Community Development Commission on May 9, 2019. See the Commissions summary below. Additionally, this memo was posted to the June 25, 2019, City Council agenda.

EVALUATION AND FOLLOW-UP

Staff will coordinate with PRNS regarding a potential fee waiver for ADU’s and provide an update in August.

Staff intends to return to the City Council in August 2019 with a request for authority to negotiate a grant agreement to the Housing Trust for an ADU forgivable loan program and an appropriation. PBCE intends to provide an update on barriers and potential solutions with respect to construction of ADU’s in August 2019. In addition, staff intends to return to the Community and Economic Development Committee and to the City Council in late 2019 with a follow-up report based on the moderate-income consultant’s report.

COORDINATION

This memorandum has been coordinated with the City Attorney’s Office, the Departments of Finance, PBCE, PRNS, 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 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

Staff’s return to the City Council in August 2019 will identify an appropriate funding source for the proposed ADU loan program. There is no cost implication for this memorandum.
COMMISSION RECOMMENDATION/INPUT

Commissioners’ comments at the May 9, 2019, meeting were wide-ranging, supporting several of the strategies mentioned in the Commission memo on moderate-income housing strategies. Comments included support for: ADU production; low-cost homebuyer loans; promotion of development incentives such as the density bonus; creation of a community land trust; use of publicly-owned land for affordable housing development; facilitating teacher housing production; lowering park fees and other fees for affordable housing; and the importance of producing housing at all levels of affordability. In addition, Commissioners commented on the need to focus more on lower-income households, those in overcrowded and substandard living conditions, and special needs populations such as seniors and disabled adults, than on moderate-income households who have greater housing choices.

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.