COUNCIL AGENDA: 12/15/2020
ITEM: 3.10

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: CITY COUNCIL

FROM: Mayor Sam Liccardo
Councilmember Lan Diep
Councilmember Pam Foley
Councilmember Johnny Khamis

SUBJECT: SEE BELOW

DATE: December 11, 2020

**Signed Electronically*

APPROVED: Sam Liccardo Johnny Khamis Lan Diep Pam Foley

DATE: December 11, 2020

SUBJECT: JOINT POWERS AUTHORITY-ISSUED BONDS FOR LOW-INCOME AND MODERATE-INCOME HOUSING

RECOMMENDATIONS

To preserve City staff capacity otherwise spent conducting extensive efforts developing and reviewing RFI's, RFQ's, and RFP's, a JPA sponsor must commit in writing through a signed agreement or other enforceable instrument, that it will meet the following minimum criteria for any project or development within the City of San José.

Staff is directed to return to Council in March with any other proposed minimum criteria which it believes Council should include in an agreement. Upon Council's approval of those criteria, Staff shall bring to City Council a resolution to join any JPA that commits to meet these criteria through a binding agreement or other legally enforceable means:

1. Zero Risk to Taxpayers:
    a. Issuance of bonds must not result in any financial risk to the City, and there can be no recourse of bondholders to the City's General Fund or other funds.
    b. City shall set a maximum level of debt that can be transferred with the property to the City's possession, and the JPA must agree to that ceiling.

2. Affordability:
    a. At least one-third of the development's units shall be "low-income," defined as at or below 80% of Area Median Income (AMI) under the definition of the U.S. Department of Housing and Urban Development (HUD).
    b. If feasible, a minimum of 5% of the units shall be made available in each development for tenants with Housing Choice Vouchers (HUD Section 8 or VASH Program). If one of these units is vacant for more than 30 days, this requirement is suspended and transferred to the development's next vacant unit.

   c. Excluding the existing tenants already residing at the property upon acquisition by a sponsor (to ensure no current tenants are displaced), none of the development's units can be leased to tenants with household income more than 120% AMI, except through an agreement struck with the City's Housing Department that provides deeper or broader affordability for the low-income units.
   d. If a remainder partial unit is created to get to one-third at 80% AMI, the sponsor must round up to the nearest whole unit.
   e. Escalation of rents of affordable units must be subject to an annual cap of 4%.

3. Vacancies:
   a. If the development is an acquisition, the initial vacancies must go first to the lowest income tier (80% AMI or lower). If one of these units is vacant for more than 30 days, the property may accept a tenant from the next lowest income tier and this requirement is transferred to the development's next vacant unit.
   b. All low-income and moderate-income vacancies must be publicized on the City's affordable housing portal (https://housing.sanjoseca.gov/).

4. Public Transparency: Any development a sponsor proposes for approval by the City shall require approval by the City Council at a public hearing for each project for which bonds shall be issued. Understanding that timeliness will be essential to any for-sale process, the City should make every effort—including expediting agenda-setting—to ensure that the public hearing does not delay or jeopardize a qualifying opportunity.

5. Cost Recovery: Any proposed development, whether ultimately approved by the City or not, shall pay the City an administration fee to cover City staff time for review, analysis, and any activity related to the JPA project proposal, proportionate with the cost recovery through the TEFRA hearing fee (cf. Council Policy 1-16), but adjusted to the appropriate amount of work.

6. Maintenance: There must exist a clear and feasible legal mechanism to enable the City's right to enforce safe property conditions in cases of mismanagement or if the property falls into disrepair. That may take the form of conditions in the property's bond regulatory agreements, or other binding agreements with the City, as the City Attorney deems appropriate.

7. Concentration and Segregation: Staff may propose appropriate geographic restrictions on developments to meet Council-approved goals regarding overconcentration and income integration.

8. Anti-Displacement: Staff may propose appropriate and lawful geographic preferences on tenants to maximize access to rent-restricted units by income-qualifying local residents, in accordance with Council-approved anti-displacement policies and Fair Housing laws.

9. Tax-Exempt Status: The sponsor must demonstrate to the City a certification of tax-exempt status by experienced tax counsel.

Discussion

We appreciate the four prospective sponsors who have already expressed interest in partnering with the City of San José in an innovative financing model to build or convert housing into low-income and moderate-income housing. Rent-restricted housing serving this large sector of our working population has proven nearly impossible to finance given the lack of public subsidy programs, and it would provide tremendous benefit to many San José residents struggling with the region's high cost of living.

Our thanks and appreciation to City staff who have diligently analyzed the potential for a JPA-issued public purpose bond program for moderate-income housing for the last two years, particularly given the more compelling and urgent demands of the pandemic on their time.

Our recommendations seek to carve a more direct path to our common goal, with far fewer demands on the scare time and resources of City staff. Rather than engaging in extensive RFI's, RFQ's, or RFP's, and substantial investigation of every offer, we propose for the City to state clearly what it wants out of these arrangements – and allow the market to respond to the City's demands.

Staff's approach will consume far more of its time and resources than appears necessary, as reflected by its stated desire in the December 15, 2020 Memorandum to extensively investigate several issues having no or little relationship to the City's fundamental objectives. For example, Staff extensively describes the many impediments to City support for a JPA arrangement, including questions about whether the units would qualify for RHNA credit, or whether the sponsor is paying fees to bond counsel or underwriters. They query whether we should first offer other property managers an opportunity to benefit from the same tax-favored treatment, even though nearly every affordable housing project is already tax-exempt by virtue of the property owners' non-profit status. They raise questions about the validity of the tax-exempt status of one JPA sponsor, even after the City was provided an assurance letter from Orrick, the most respected public tax experts in the state. During the Rules Committee hearing, one member of City staff even emphasized the importance of fully vetting the investors' financial benefits, as if the City would require entities to "open their books" prior to entering any agreement—even though we've never made those demands of any investors in state bonds or low-income housing tax credits in any of our affordable housing projects.

These issues raise concerns about whether Staff is appropriately allocating its very scarce time and resources, and the concerns are compounded by Staff's reasonable and justifiable assertion that its pace of progress on this initiative over the last two years is constrained by its lack of resources. We agree that Staff is swamped, and we express gratitude for Staff's tremendous work under those constraints. But there is another way to address a resource shortage than simply putting this concept in the back of the queue, when an affordable housing shortage will persist. The alternative path: focus – and stop doing the rest. That is, let's focus on what we—and the public—should care about most in these deals—such as whether the JPA sponsors are delivering a sufficient amount of affordable housing, at a sufficient depth of affordability, and whether taxpayers and City are protected—and let go of the less relevant issues. We should let the sponsors decide how much they want to pay their bond counsel—that comes out of their pocket, not our taxpayers'.

There's a more fundamental concern about Staff's approach: our general disposition toward partnerships with entities outside of City Hall. We're not building anywhere near enough affordable housing in San José, largely because the City lacks the resources to do so. Until now, our model for affordable housing has largely depended on direct participation of the City, Redevelopment Agency, Housing Authority, County, or other public entity.

Continuing to demand that the City do it all—and control it all—will ensure that we continue to fall short. We desperately need partners—including private-sector partners—because of our lack of public resources. Any partnership inherently requires sacrificing some level of control; otherwise, we'd just do it all ourselves. The better focus of our energy is not on our level of control, but on whether we can obtain what we want—and what our community needs—out of a JPA partnership, such as sufficient affordability restrictions, health and safety of the tenants, and the insulation of the City from financial risk.

We hope to find balance between understandably strained and limited staff capacity and seizing upon the opportunity for low-income and moderate-income housing without public affordable housing funding.

Of course, there is a public subsidy in these JPA-backed affordable housing arrangements, in the form of a property tax exemption, and in the issuance of tax-exempt bonds. Forgoing property tax revenue is nothing unusual—virtually every other affordable housing project in the City avoids property tax by virtue of its non-profit status. Unlike any of those affordable housing projects, these developments will impose rent restrictions without another single dime of City, County, or State funding. In contrast, the City's current policy authorizes an expenditure of about $125,000 per unit of City funding for an affordable housing project—combined with other government subsidies, such as Federal and State Low-Income Housing Income Tax Credits, Measure A funds, and State housing program grants.

A back-of-the envelope calculation of the foregone City share of unpaid property tax for a typical 100-unit development (assuming a 15-year duration, prior to City acquisition, as is currently proposed) with a very high valuation of $70 million is a net present value of less than $1 million. Under the City's approach to development, the same $1 million would enable the development of 8 units—*after we combine the City subsidy combined with many other public subsidies*. This model of financing enables far more units, without the other large public subsidies.

Most importantly, the public benefit substantially outweighs this modest cost, particularly given our historic inability to add low-income and moderate-income housing units to our housing stock and given that the City can acquire title to the property—and institute even deeper levels of affordability—in the out years.

We recognize that JPA-issued public purpose bonds are relatively novel for the financing of low-income and moderate-income housing, and we hope to lean into this challenge by clearly defining the terms for the City's participation in such ventures through a public process.