



# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** TEACHER HOUSING  
ON SCHOOL LAND

**DATE:** May 31, 2016

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Approved

Date 5/31/16

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## BACKGROUND

In the Mayor's March Budget Message, (page 15, item C) the City Manager was directed to prepare an estimate of inclusionary and impact fee revenue for the next two to three years, to enable Council and staff to assess whether this source might suffice to support a pilot project or two with participating districts" to help provide affordable workforce housing for teachers and staff on school district land.

## ANALYSIS

The Department has refined its revenue assumptions for the Affordable Housing Impact Fee (AHIF) and in-lieu fees projected from the Citywide Inclusionary Housing Ordinance (IHO). A table summarizing the projections is provided in **Attachment A** to this memo. A narrative explaining those projections and their potential ability to provide affordable housing for teachers and staff on school district land is provided below.

Central to this discussion is the compliance with Fair Housing Laws. The City is required to comply with Fair Housing Laws that require equal access to housing. Before any funds are allocated for a specific proposal, an analysis of the proposal for fair housing compliance would need to be completed.

### Affordable Housing Impact Fee (AHIF)

#### Revenue Projection

In an effort to minimize negative financial impacts on development projects that have already started the development review process (the "pipeline), the AHIF was approved with exemptions, contingent upon certain conditions (pipeline exemption). As a result, the

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Department does not anticipate receiving significant revenue in 2016-2017. The Department is projecting the receipt of \$13.5 million in 2017-2018 and \$9.0 million in 2018-2019, for a total of \$22.5 million over the next three fiscal years.

The AHIF requires expenditures to be based upon the need for affordable housing as stated in the Nexus Study and the adopted Resolution which established the AHIF program on November 18, 2014. Any project to be funded from the AHIF must be added to the AHIF Expenditure Plan. The AHIF Resolution states that 28.7% of revenue be spent on low-income housing targeted to households earning between 60% and 80% of the Area Median Income (AMI). This equates in \$3.9 million in 2017-2018 and \$2.6 million in 2018-2019, for a total of \$6.5 million available for the 60% to 80% AMI population over the next three years. These funds could be used to fund the development of affordable rental housing.

The AHIF Ordinance also states that 14.3% of the fee revenue must be spent on affordable housing for households earning between 80% and 120% of Area Median Income. This equates to \$1.9 million in FY 2017-18 and \$1.3 million in FY 2018-19 for a total of \$3.2 million over three years. These funds could be used for homeownership opportunities.

### **Citywide Inclusionary Housing Ordinance**

#### **Revenue Projection**

The recently enacted Citywide IHO allows developers of market rate housing to pay an in-lieu fee as an alternative to providing affordable apartments in the developments. The Citywide IHO also provided a grace period for all projects that acquired all of their Planning permits on or before June 30, 2016. As such, the Department does not expect significant revenue in 2016-2017 from the Citywide Inclusionary Ordinance. In-lieu revenues generated as a result of the Citywide Ordinance are anticipated to be \$7.9 million and \$10.4 million in 2018-2019 for a total of \$18.3 million.

In addition to in-lieu fees from developments subject to the new Citywide Ordinance, the Housing Department is anticipating to receive revenue from developments subject to the Inclusionary Policy that applies to the former redevelopment areas. Revenue from this source is projected to be \$11.5 million over the next three years.

These revenue estimates assume that all developers pay the in lieu fee instead of providing the affordable units. This is based on discussions with developers pursuing projects with inclusionary requirements that are not exempt from the Ordinance. Thus far, owners of all non-exempted developments are intending to pay the fee in lieu of providing the affordable homes on site. This scenario could change based on market conditions and if it is financially feasible for a developer to build the affordable for-sale homes or rental apartments.

Revenue from inclusionary in-lieu fees can be spent on either rental or for-sale affordable housing development with incomes up to 120% of AMI. Accordingly, the City Council could

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prioritize all of this revenue to provide housing for teachers and school district staff should such a proposal also include an approved analysis for fair housing compliance.

### **Affordable Housing Options**

#### **Affordable Rental Housing Construction Financing**

The City traditionally uses its funds to finance affordable rental housing for residents with incomes targeted at 60% AMI or less. This allows the City to leverage other public funding sources such as tax exempt bonds and tax credit equity financing which are restricted to tenants with incomes less than 60% AMI. Without such financing, the City's contribution would likely need to be much greater.

Per Salary.com, the median annual teacher high school salary in San José, CA is \$67,445, as of April 26, 2016, with a range between \$53,439-\$79,222 (not including bonus and benefit information and other factors that impact base pay), for example. Therefore, for affordable rental housing to be viable, rental households must have incomes that do not exceed 60% AMI. The current AMI ranges between \$41,000 and \$64,000 depending upon family size. Most teachers would not be eligible for affordable rental housing. A conversation with one school district official confirmed that the teacher salaries in that district exceed the rental income caps. However, there may be interest in providing housing for other school district staff that meet the income limits.

#### **For-Sale Housing Construction Financing**

The City may fund for-sale housing for moderate income households up to 120% of AMI with either inclusionary in-lieu fees or AHIF revenue. Teachers and many school district personnel are likely to meet the income qualification. That being said, the Housing Department has not participated in the funding of construction opportunities for the past 10 years due to the risks, such as market variables and fluctuations, associated with for-sale products. The City has had negative experiences financing for-sale housing developments in the past. On one occasion, construction cost overruns were the result of an over-heated market which drove materials prices much higher than budgeted. Conversely, the Department also financed several projects which came to market during an economic downturn. As a result, sales prices did not meet market projections. When these situations occur, intense pressure is placed on the City to provide additional funding to save the developments or the developer is unable to repay what was originally structured as a loan, or the number of affordable homes decreases in the project to make it more financially feasible.

In addition, the costs for for-sale units have increased dramatically since the City last participated in funding affordable for-sale projects. The subsidy needed from the City to help fund the construction of new affordable homes would now be cost prohibitive.

### Homebuyer Second Mortgage Assistance

In order to avoid market fluctuations and construction-related cost risks, the Housing Department has opted to assist moderate- income homeowners with deferred second mortgage loans. These loans reduce the homebuyer's first mortgage payment, thus lowering their payment and making them eligible for homeownership opportunities for which they would otherwise not qualify. Should the City to use this approach, the Housing Department would provide the school district and developer with a commitment to provide down-payment assistance for a specified number of homebuyer loans prior to construction. The loans would be provided to buyers of newly constructed units as the homes are sold. The disadvantage of this approach from a developer's perspective is that the developer assumes all of the construction risk.

Should the City opt for a second mortgage program, the size of the deferred loan would need to be determined. In the past, the City provided loans up to \$60,000. However, in the peak of the housing market, these loans were being combined with State-funded deferred second mortgages in order to make the home affordable to a moderate- income homebuyer. Therefore, the subsidy in today's market could be between \$100,000 and \$150,000 for homes sold between \$500,000 and \$550,000.

Assuming the City is able to find a school district pilot program partner, the cost to subsidize 50 homes is estimated between \$5 million and \$7.5 million. While there are fair housing issues and programmatic questions that need to be addressed, the revenue estimates indicate that there are sufficient revenues from the AHIF and IHO in lieu fees to support funding of a pilot project.

### EVALUATION AND FOLLOW-UP

Over the next few months, the Housing Department will reach out to different school districts to explore interest and viability of working collaboratively to fund affordable housing for teachers and staff on school property. The Housing Department will report back to the Community and Economic Development Committee by the end of the calendar year on the efforts to of the feasibility on the programmatic issues and willingness of potential school district pilot program partners to help provide affordable workforce housing for teachers and staff on school district land.

### COORDINATION

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

/s/  
Jacky Morales-Ferrand  
Director of Housing

For questions regarding this memorandum, please Jacky Morales-Ferrand at (408) 535-3855.

## ATTACHMENT A

### Estimate of Affordable Impact and Inclusionary In lieu Fee Revenue

<b>Affordable Housing Impact</b>				
<b>Fee</b>	<b>2016-2017</b>	<b>2017-2018</b>	<b>2018-2019</b>	<b>Total</b>
Extremely Low Income (ELI) (30%) - 23.0%	\$ -	\$ 3,105,000	\$ 2,070,000	\$ 5,175,000
Very Low Income (VLI) (50%) - 34.0%	\$ -	\$ 4,590,000	\$ 3,060,000	\$ 7,650,000
Low Income (LI) (60-80%) - 28.7%	\$ -	\$ 3,874,500	\$ 2,583,000	\$ 6,457,500
Moderate Income (MI) (80-120%) - 14.3%	\$ -	\$ 1,930,500	\$ 1,287,000	\$ 3,217,500
<b>Total Projected Affordable Housing Impact Fee</b>	<b>\$ -</b>	<b>\$ 13,500,000</b>	<b>\$ 9,000,000</b>	<b>\$ 22,500,000</b>
<b>Inclusionary Housing Ordinance</b>				
Fees from Projects Subject to City-Wide Ordinance	\$ -	\$ 7,900,000	\$ 10,400,000	\$ 18,300,000
<b>Inclusionary Housing Policy</b>				
Fees From Projects Subject to Existing Policy	\$ 2,000,000	\$ -	\$ 9,500,000	\$ 11,500,000
<b>Total</b>	<b>\$ 2,000,000</b>	<b>\$ 21,400,000</b>	<b>\$ 28,900,000</b>	<b>\$ 52,300,000</b>
<b>Total Potential Housing Funds Available to Teachers/School District Staff</b>	<b>\$ 2,000,000</b>	<b>\$ 13,705,000</b>	<b>\$ 23,770,000</b>	<b>\$ 39,475,000</b>
For Rent Only		\$ 3,874,500	\$ 2,583,000	\$ 6,457,500
For-Sale Only		\$ 1,930,500	\$ 1,287,000	\$ 3,217,500
Either Use (For-Sale or for Rent)	\$ 2,000,000	\$ 7,900,000	\$ 19,900,000	\$ 29,800,000

*Note: Revenue estimates are derived from the Department of Planning, Building and Code Enforcement's projection of housing construction activity. Figures have been further refined to account for developments that will meet the NAHIF and Inclusionary Ordinance exemption requirements. The shaded rows for Extremely Low Income and Very Low Income are not available for teacher or school district staff housing based on income requirement limitations.*