Housing for Working Families – How Do We Pay for It?
Informational Hearing
Senate Transportation and Housing Committee
Senate Governance and Finance Committee
Tuesday, October 2, 2018, 1:30pm, Room 4203

Background Paper

Introduction and Purpose of the Hearing

This hearing is the first of two hearings jointly held by the Transportation and Housing Committee and the Governance and Finance Committee and will assess current state and other funding for affordable housing, seek to identify funding gaps, and begin a discussion of why funding alone is not sufficient to address the state's housing crisis. The second hearing will focus on the effects of land use policies on housing affordability and non-fiscal policy options to address California's housing needs.

California's Housing Crisis

California is in the midst of a serious housing crisis. Homeownership rates in the state have fallen to the lowest rate since the 1940s. California is home to 21 of the 30 most expensive rental housing markets in the country, which has had a disproportionate impact on the middle class and the working poor. A person earning minimum wage must work three jobs on average to pay the rent for a two-bedroom unit. Housing units affordable to low-income earners, if available, are often in serious states of disrepair. Additionally, while California is home to 12 percent of the nation's population, it represents a disproportionate 22 percent of the nation's homeless population.

A major factor in this crisis is the state's housing shortage. From 1954-1989, California constructed an average of more than 200,000 new homes annually, with multifamily housing accounting for the largest share of housing production. Since then, however, construction has dropped significantly. The state Department of Housing and Community Development (HCD) estimates that approximately 1.8 million new housing units – 180,000 new homes per year – are needed to meet the state's projected population and housing growth by 2025. Even when housing production rose in the mid-2000's, it never reached the 180,000 mark, and over the last 10 years construction averaged just 80,000 new homes per year.

State law requires local jurisdictions to plan for their future housing needs, as determined through the regional housing needs allocation (RHNA) process. Under RHNA, the Department of Finance and HCD develop forecasts of the number of housing units at various income levels needed to keep pace with population growth, which they allocate to regions throughout the state. Regional "councils of governments" allocate the regional housing need to local governments within those regions, which must develop a plan – the housing element portion of their general plan – to accommodate the additional housing growth. During the most recent housing element cycle, not a single region built sufficient housing to meet its regional housing need. For example, of the two most populous regions of the state, the Southern California Association of Governments region produced 46% of its respective need and the Association of Bay Area Governments produced 53% of its need. Statewide, only 47% of the housing required to meet projected need was constructed during this period. This is due in part to the limited ramifications communities have faced if their housing element is not approved by HCD; to address this problem, the Legislature passed a number of bills last year aimed at strengthening housing element law.

California's housing shortage has had a disproportionate impact on lower-income families. According to the National Low Income Housing Coalition, while needs vary by region, California has a statewide *surplus* of above moderate/market rate housing (about 300,000) but suffers a *shortfall* of about 1.5 million units for extremely low- and very low-income households (at or below 50 percent of area median income). As a result, HCD estimates that approximately 2.7 million lower-income households are rent-burdened (meaning they spend at least 30 percent of their income on rent), 1.7 million of which are severely rent-burdened (spending at least 50 percent of their income on rent).[1]

Legislative Actions

Last year, the Legislature enacted several measures address the housing crisis, which included bills to create and preserve affordable housing, streamline housing development, and establish accountability and enforcement measures. The Senate Transportation and Housing Committee and the Assembly Housing Committee held a joint hearing in February 2018 on implementation of the housing package.[2]

The 2017 housing package included two measures to provide funds for affordable housing. SB 2 (Atkins, 2017), the Building Homes and Jobs Act, creates a $75 charge on certain real estate documents. The bulk of the proceeds will be allocated to cities and counties to fund affordable rental and ownership housing for low-income and middle-income households. The recently enacted state budget allocates $122.6 million in first-year SB 2 funds. SB 2 directs half of the first year of recording fee funds to support housing planning by local jurisdictions; the budget allocates the other half to the Housing for a Healthy California Program, which supports housing for chronically homeless Medi-Cal beneficiaries who meet specified criteria, including being eligible for Supplemental Security Income. In addition, SB 3 (Beall, 2017), the Veterans and Affordable Housing Bond Act of 2018, will authorize the issuance of $4 billion in general obligation bonds for affordable housing programs and a veterans' homeownership program, if approved by voters next month.

[1] California Department of Housing and Community Development, *California's Housing Future: Challenges and Opportunities, Final Statewide Housing Assessment 2025* (February 2018) at http://www.hcd.ca.gov/policy-research/plans-reports/docs/SHA_Final_Combined.pdf.

[2] Oversight Hearing: Joint Hearing of the Senate Transportation and Housing Committee and the Assembly Committee on Housing and Community Development, "Implementation of the 2017 Housing Package," February 21, 2018, at https://stran.senate.ca.gov/sites/stran.senate.ca.gov/files/joint_housing_packet.pdf.

The Legislature took further steps in 2018 to encourage housing production, including bills to make the RHNA process more accountable and transparent, facilitate production of supportive housing, ease siting of transit-oriented housing, and strengthen density bonus law, among others. In addition, the Legislature passed and the Governor signed a state budget that includes a significant infusion of funds for affordable housing, as discussed below.

Funding for Affordable Housing

The state supports a variety of housing programs that target low- and moderate-income households and homeless populations. Major programs include:

- CalHome, which provides: (1) grants to local public agencies and nonprofit developers to assist individual first-time homebuyers; and (2) loans to developers for projects that will have multiple owners, including single-family home subdivisions.
- Multifamily Housing Program (MHP), which finances construction, rehabilitation and preservation of permanent and transitional rental housing for lower income households.
- Veterans Housing and Homelessness Prevention Program (VHHPP), which supports the acquisition, construction, rehabilitation, and preservation of affordable multifamily housing for veterans and their families.
- Affordable Housing Sustainable Communities Program (AHSC), which provides grants and loans to support infill and compact development projects that reduce greenhouse gas emissions.

The HCD administers CalHome, MHP, and VHHPP, as well as AHSC (in conjunction with the Strategic Growth Council). In addition, the Department of Social Services administers the CalWORKs Housing Support Program and the CalWORKs Homeless Assistance Program, which provide various forms of assistance to help CalWORKs families that are homeless or at risk of becoming homeless to quickly obtain or retain permanent housing and afford temporary shelter. The California Housing Finance Agency (CalHFA) also operates several loan programs to enable low-income households to purchase homes and offers financing to multifamily developers to acquire, rehabilitate, or construct affordable rental housing.

Finally, a major source of financial assistance for affordable housing is the federal Low Income Housing Tax Credit (LIHTC) program. The LIHTC is an indirect federal subsidy developed in 1986 to encourage the private development of affordable rental housing for low-income households. The federal LIHTC program enables affordable housing sponsors and developers to raise project equity through the allocation of tax benefits to investors. Taxpayers claim LIHTCs approximately equal to a specified percentage of the project's "basis"—essentially project costs minus land acquisition and transaction costs—over a certain number of years, and start claiming the credit in the taxable year in which the project is placed in service. Projects must remain affordable to residents for 55 years. In 1987, the Legislature authorized a state LIHTC program to augment the federal tax credit program. State tax credits can only be awarded to projects that have also received, or are concurrently receiving, an allocation of the federal LIHTCs. The amount of state LIHTC that may be annually allocated by TCAC is limited to $70 million, adjusted for inflation. This year, the total credit amount available for allocation was about $99 million.

California has seen a significant reduction of funding at the state level in recent years, in addition to federal funding cuts. Proposition 46 of 2002 provided $2.1 billion for a variety of affordable housing programs, and Proposition 1C of 2006 provided an additional $2.85 billion. As important as housing bonds are, however, they are a short-term strategy. Both Proposition 46 and Proposition 1C provided roughly 4-5 years of funding, and HCD has awarded most of these funds.

The dissolution of redevelopment agencies (RDAs) in 2011 further reduced funding for affordable housing. RDAs financed affordable housing development by issuing bonds backed by a portion of the property tax diverted from other local agencies and, in the case of the school share of the property tax, backfilled by the state's General Fund. State law required redevelopment agencies to allocate 20 percent of their funds on housing affordable to moderate and lower-income families.

After RDAs were dissolved, local officials sought other ways to use tax increment financing to raise capital to fund public works projects. In response, legislators enacted a number of measures creating new tax increment financing tools to pay for local economic development. In 2014, the Legislature authorized the creation of Enhanced Infrastructure Financing Districts (EIFDs) (SB 628, Beall, 2014), quickly followed by Community Revitalization and Investment Authorities (AB 2, Alejo, 2015). Just last year, the Legislature authorized the formation of Affordable Housing Authorities, which may use tax increment financing exclusively for rehabilitating and constructing affordable housing and do not require voter approval to issue bonds (AB 1598, Mullin, 2017). The Legislature also allowed certain EIFDs to form under the Neighborhood Infill Finance and Transit Improvements Act—known as "NIFTIs"—to capture sales taxes from local governments that voluntarily participate (AB 1568, Bloom, 2017). Finally, the Governor recently signed SB 961 (Allen), which allows some EIFDs to issue debt for affordable housing and related infrastructure without requiring a public vote. However, none of these tools are able to capture the school share and all rely on voluntary commitments by affected taxing agencies to contribute funds, which significantly limits their revenue potential.

In sum, with the loss of redevelopment and expenditure of the last voter-approved housing bonds, $1.5 billion of annual state investment dedicated to housing has been eliminated.

The state has made efforts to fill these funding gaps through the passage of $2 billion on bonds to establish the "No Place Like Home" program, $150 million in new funding for homeless programs in the 2016-17 Budget Act, $600 million for the Veterans Housing and Homelessness Prevention Program in 2014, and a 20% allocation of Greenhouse Gas Reduction Fund revenues to fund the AHSC Program, with at least half of AHSC funds designated for affordable housing. Local governments have approved numerous measures to fund affordable housing. Specifically, in November 2016, local jurisdictions approved $2.7 billion in local general obligation bonds, along with two local sales tax increases for affordable housing, and in June 2018 the City of Emeryville approved a $50 million affordable housing bond. Several additional measures will appear on the November 2018 ballot in various jurisdictions. This includes proposed housing bond measures in Santa Cruz County and in the cities of Berkeley, Santa Rosa, and San Jose, as well as proposals to dedicate certain revenues to housing in San Francisco and Napa County.

While the 2017-18 Budget Act provided some increased funding for housing, the 2018-19 Budget Act allocates $2.7 billion for a variety of affordable housing and homelessness prevention programs over the next four years. This amount includes $875 million from SB 2 revenues spread across several programs, with $489 million allocated directly to cities and counties. Outside of SB 2 funds, major new expenditures include:

- $500 million for the Homelessness Coordinating and Financing Council to provide block grants to localities.
- $223.1 million for CALWORKs Housing Support and Housing Assistance Programs.
- $50 million for county mental health services for homeless individuals.
- $15 million for a pilot program under Adult Protective Services to address homelessness among seniors.
- $11 million for domestic violence shelter services ($10 million) and homeless youth shelters ($1 million).

In addition, the 2018-19 Budget Act allocates SB 3 funds to a variety of programs, if voters approve the measure in November 2018.

The Budget also includes a proposal to allocate "overflow" revenues from the "rainy day fund" to infrastructure, including housing. The state is constitutionally required to set aside up to 10 percent of General Fund revenues in a reserve. For any overflow" rainy day funds in 2019-20 through 2021-22, the Budget directs the first $415 million to deferred maintenance related to state buildings and funds, and splits the remainder evenly between rail infrastructure and MHP. The MHP allocation is estimated to be $300 million per year for the three-year period.

<u>Increased Funding Is Inadequate to Meet Need</u>

The state and local governments have taken steps to provide additional funding for affordable housing in recent years, as well as to make changes to local approvals of housing. However, even with these new sources of funds, a significant gap in housing production at all income levels is likely to remain, hampering the ability of the state to address housing affordability through funding alone. For example, according to the Legislative Analyst's Office (LAO), the amount of public funds needed to provide affordable housing to the 1.7 million low-income households in California that are severely rent-burdened (spending at least 50% of their income on housing) totals over $250 billion.[3] Similarly, a 2016 report by the McKinsey Global Institute identified an *annual* gap of $50 to $60 billion needed to ensure affordability for the 5.9 million households at all income levels that can't currently afford housing.

[3] Legislative Analyst's Office, *Perspectives on Helping Low-Income Californians Afford Housing* (February 9, 2016) at https://lao.ca.gov/Publications/Report/3345.

While some of this gap may be filled by sources other than direct state expenditures (such as federal Low Income Housing Tax Credits), the California Housing Partnership Corporation estimates that, on average, a developer requires $67,000 in assistance from the state's MHP to build each housing unit. Based on these numbers, meeting the state's needs for housing affordable to severely rent-burdened lower-income families would require approximately $114 billion from the MHP. In addition, this amount does not include funding to assist the roughly one million lower-income households that are rent-burdened, but not severely so. The amount of funding needed substantially exceeds the recently approved funding for affordable housing, which is expected to generate approximately $9 billion over the next five years.

Accordingly, it is unlikely that increased funding alone can ensure affordable housing for many Californians; additional unsubsidized housing production is needed to rein in California's housing prices in the long term. A variety of causes have contributed to the lack of housing production. Recent reports by LAO and others point to local approval processes as a major factor. They argue that local governments control most of the decisions about where, when, and how to build new housing, and those governments are quick to respond to vocal community members that may not want new neighbors. The building industry also points to environmental reviews and other permitting hurdles. These issues pose challenges to constructing market-rate and affordable housing developments alike. In addition, the lack of affordable housing also works against the state's environmental goals, as people "drive until they qualify"—resulting in longer commutes to the workplace as people seek housing that they can afford.

Next Steps

While this hearing is primarily focused on financing affordable housing, the Senate Governance and Finance Committee and the Senate Transportation and Housing Committee will hold an additional hearing later in the fall to explore barriers to local approval of new housing in close proximity to job centers. Throughout these hearings, the two committees will be exploring solutions that can be adopted to effect change at a regional level—acknowledging that one size does not fit all and that solutions that apply to the state's major metropolitan areas may not work in rural or suburban areas. At the same time, these solutions must ensure that all communities across the state do their part to address the housing crisis. These solutions may include policy changes and financial incentives, and a successful path forward will include both carrots and sticks to encourage cities and counties to permit housing—some of which will be unpopular among local officials and others that will be welcomed.