



Good Neighbors

San Diego
Housing Commission

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REPORT

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ITEM 106

REPORT NO: HCR03-023
For the Agenda of February 21, 2003

SUBJECT: FY2004 Budget Workshop – Discussion on Use of Unrestricted Funds to Provide Affordable Housing (Citywide)

SUMMARY

Issue: Should the Housing Commission continue to use a multifaceted approach to provide affordable housing?

Recommendation: Approve the approach currently used to provide affordable housing through a variety of activities.

Fiscal Impact: Funding allocations for the FY2004 Housing Commission budget will be developed based on this budget workshop discussion.

DISCUSSION

The Housing Commission's Three Year Strategic Plan for FY2003-FY2005 includes the strategic goal of significantly increasing the number of affordable housing units in the City. The Housing Commission's Business Plan, approved by the Housing Authority on February 11, 2003, articulates specific activities for increasing production, preservation and development of affordable housing through financing and ownership of multifamily rental housing, funding of housing rehabilitation programs, and funding of homebuyer assistance products. The Housing Commission uses its unrestricted funds to pay for these activities.



Goals established by the Department of Housing & Urban Development (HUD) for its proposed FY04 budget complement local activities and include:

- Promoting decent affordable housing
- Increasing homeownership opportunities
- Strengthening communities
- Ensuring Equal Opportunity in housing
- Promoting the participation of faith-based and community organizations
- Embracing high standards of ethics, management and accountability

Today's workshop will focus on the possible uses of Housing Commission funds to address local and federal goals.

Sources of Funds

Much of the Housing Commission's annual budget is comprised of "restricted" funds that must be used for specific programs and purposes, e.g., Section 8, public housing, capital funds and lead hazard control. In FY2003, the amount of "unrestricted" funds available for housing finance and development activities totaled \$14.2 million out of a budget of approximately \$148 million. Primary sources are HOME funds, Housing Trust Fund, and local funds.

For FY2004, the early estimate of unrestricted funds (known sources) is \$12.3 million. This decrease is due to lower fee collections for the Housing Trust Fund and less anticipated carryover of funds from FY2003.

It is possible that additional funds will be available in FY2004; however, these sources are not yet confirmed. There may be up to \$1 million available mid-year from the Proposition 46 Housing Bond program for Housing Trust Fund match funds. If an Inclusionary Housing Ordinance is put in place, in-lieu fees will be collected. The requirements for expenditure of these sources are not yet known, so this revenue is not included in the FY04 budget estimates. It is customary for the Housing Commission to amend the budget mid-year to reflect any new revenue received after approval of the initial budget.

Another new factor for FY04 is the Redevelopment Agency Notice of Funding Availability, which is intended to provide up to \$55 million in funding for affordable housing development in the next five years. Although not a component of the Housing Commission budget, these funds could provide more local financing for affordable housing development.

Uses of Funds

During the annual budget preparation process, the Housing Commission holds discussions on ways to best utilize its unrestricted funds to respond to the growing need for affordable housing. Generally, the Housing Commission has allocated funds based on needs identified, program costs and market conditions, and the amount of unrestricted funds available. In addition, actions by Congress and by HUD influence local housing activities; in recent years, both entities have

encouraged housing agencies to actively pursue development of mixed income housing to provide a source of operating funds to the agencies. (Agencies in Washington, Pennsylvania, California and elsewhere are pursuing this course of action.)

Annually, the Housing Commission has funded a mix of multifamily rental development, homeownership, and housing rehabilitation. Multifamily rental development proposals are typically solicited through a Notice of Funding Availability (NOFA) that describes available funding and underwriting standards. Rehabilitation funds are available on a first-come, first-served basis as is shared equity financing for homebuyers.

In addition to acting as a lender, the Housing Commission has the ability to own and operate affordable housing. Staff is actively investigating development and ownership opportunities that could enhance revenue opportunities for the Housing Commission in order to broaden the range of revenue sources, protect against volatility in other funding sources in the future and relieve Housing Commission dependency on Federal funding.

In FY 2003, the Commission allocated approximately 59 per cent of its unrestricted funds to rental housing production (\$8.4 million), 17 per cent to homeownership activities (\$2.4 million), 12 percent to Special Purpose Housing (\$1.7 million) and 12 per cent to rehabilitation activities (\$1.7 million). Restricted funds (CDBG, HUD, Redevelopment Agency) added approximately \$4.4 million in funding for these activities.

FY2003	Restricted	Unrestricted	Total
		HOME, Other	
Rental	100,000 CDBG	8,400,000	8,500,000
Home Ownership	1,000,000 CCDC	2,400,000	3,400,000
Rehabilitation	3,300,000 CDBG, HUD	1,700,000	5,000,000
Special Purpose		1,700,000	1,700,000
Totals	4,400,000 Various	14,200,000	18,600,000

FY2004 (Projected)	Restricted To Be Determined	Unrestricted HOME, Other (Based on FY03)	Total
Rental	Inclusionary, Proposition 46	7,400,000	
Home Ownership	Inclusionary, Various	2,350,000	
Rehabilitation	CDBG, HUD	1,300,000	
Special Purpose		1,200,000	
Totals		12,250,000	

Attachment 1 provides examples of the housing activities with related costs; Column B shows the estimated average per unit subsidy. For rental housing production, actual subsidy per unit varies widely, depending on type of housing and availability of other financing tools.

Attachment 2 provides a narrative comparison of the activities including advantages and disadvantages of each activity/category.

Discussion Points

With the information available at this time, at least two issues have been identified for discussion: 1) should the Housing Commission increase or decrease the percentage of unrestricted funds allocated to various activities? and 2) should the Housing Commission set aside funds for the Housing Commission or Housing Development Partners to pursue development opportunities?

Board direction from this and future budget workshops will be incorporated into the FY2004 budget.

Respectfully submitted,

**Signature on File
With Original Document**

Approved by,

Jack D. Farris
Manager, Housing Finance & Development

Elizabeth C. Morris
Chief Executive Officer

- Attachments: 1) Chart of Various Activities
2) Narrative Comparison
3) SDHC Income and Rent Calculations February 2002

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CHART OF VARIOUS ACTIVITIES

(a)	(b)		(c)	(d)	(e)	(f)		(g)
Activities	Estimated Possible Units		With \$1,000,000 How many units could be assisted? (\$1,000,000 divided by Column b)	Estimated Cost per Affordable Unit/Year		Affordability Level		This Program's Estimated Actual Affordability Level
	This Program's Estimated Per Unit Average Housing Commission Subsidy	This Program's Years of Required Affordability		Estimated Per Unit Average Subsidy Per Year (Column "b" divided by column "d")	This Program's Maximum Affordability Level			
RENTAL HOUSING PRODUCTION Acquisition/Rehabilitation/New Construction	\$40,000 per unit	Provides 25 unit	55 years	\$727	60%	52%		
HOMEOWNERSHIP (Shared Equity 2 nd TD+Downpmt grant)	\$65,133 per unit	Provides 15 units	15 years	\$4,342 Per unit per year	80%	67%		
(Homebuyer Acquisition/Rehabilitation)	\$75,000 per unit	Provides 13 units	15 years	\$5,000 Per unit per year	80%	58%		
REHABILITATION (Rental Housing)	\$5,000 per unit	Provides 200 units	10 years	\$500 Per unit per year	60%	50%		
REHABILITATION (Owner Occupied 1 unit zero int deferred loans)	\$6,100 per unit	Provides 163 units	No term -- payable upon sale, refinance, or transfer	N/A	50%	32%		
(Owner Occupied 1-4 unit 3% int, 15yr loans)	\$25,000 per unit	Provides 40 units	15 years	\$1,666 Per unit per year	80%	45%		

NARRATIVE COMPARISON OF VARIOUS ACTIVITIES

- I. **Rental Housing Development** - provides financing to nonprofit and for-profit entities for production or preservation of affordable rental housing (includes new construction, acquisition and acquisition/rehabilitation). Non-categorical funds (for example, the HOME Program and the Housing Trust Fund) can be used for rental housing production.

Advantages of Rental Housing Development Activity:

- *Economic Effectiveness*
 - Low long-term cost per affordable unit per year (see Chart Attachment 1): Rental housing allows investment of Housing Commission resources to achieve assistance for the longest period of time.
 - Repayment: Rental housing development loan funds typically are due to be repaid (with 3% interest) at the end of fifty-five years, and/or with periodic payments of a portion of residual receipts, as available.
 - Leverage: Rental housing projects typically leverage substantial private funds; for example, tax credit equity and bond financing can provide more than fifty percent of the funds needed for development. The design, construction, and rehabilitation of housing create local jobs directly and indirectly. Home building/rehabilitation results in an economic multiplier effect for the local economy.
- *Neighborhood/Societal Benefits*
 - Helps revitalize and stabilize neighborhoods: Improving troubled rental properties can improve neighborhood stability and further neighborhood improvement goals.
 - Rental housing development assures a long-term supply of affordable housing available to successive low-income residents. Vacant, abandoned or blighted buildings can be restored to increase the affordable housing stock.
 - New construction can increase the supply of affordable rental units. Although development of low-income housing is generally unwelcome in most neighborhoods, housing affordable to a mix of household incomes generates more public support.
- *Affordability Level*
 - Rental housing development serves very low-income renters (the vast majority of people actually being assisted are at or below 60% of area

median income). The greatest housing need identified under the Consolidated Plan is among very-low and low-income renters.

Disadvantages of Rental Housing Development Activity:

- *Economic Effectiveness*
 - The per-unit average up-front subsidy for acquisition/rehabilitation projects is \$40,000. Costs are partly due to: the need to abate lead based paint and asbestos; federally-required relocation payments to displaced tenants; Davis-Bacon prevailing wage costs; development costs/fees. (Relocation costs are often mitigated because existing tenants are often income-eligible.)
 - Repayment is often from a portion of residual receipts, subject to availability of funds.
 - A strengthening local real estate market may increase the value/sales prices and result in an increase in purchase gap subsidy needed from the Housing Commission.
 - Some projects may fail, leading to defaults and potential loss of Housing Commission loan funds.

- *Other Considerations*
 - The complexity and nature of development/rehabilitation results in a relatively long implementation period from proposal to tenant occupancy; it is slower than homebuyer programs.
 - Useful life of existing rental buildings is less than the fifty-five year affordability term. Extending the building life for lengthy affordability periods requires both initial rehabilitation expenditures and a high level of ongoing maintenance and repair. It also requires careful long-term monitoring by Housing Commission staff (under a formal agreement) to ensure that the developer maintains adequate replacement reserves to provide funds for necessary on-going repairs and to preclude the need for additional rehabilitation subsidy in future years. Also long-term project monitoring of affordability is required.

- **New Construction versus Acquisition**

Advantages:

- Better design opportunities (such as play area, sufficient parking, and security) can be incorporated; as well as opportunities for maximal neighborhood improvement;
- For vacant land, there is no relocation expense;
- The remaining useful life is longer;
- Construction quality is controllable; and

- Leverage opportunities are greater (the Federal Tax Credit Program generally favors new construction).

Disadvantages:

- Cost per unit is higher;
- Production schedule is longer;
- Development is more complex; requiring development staff with a higher skill level; and
- Leverage opportunities are subject to availability (the Federal Tax Credit Program is frequently oversubscribed).

II. Homeownership Activity - provides financial and technical assistance to first-time homebuyers directly and to private entities operating homeownership programs. Non-categorical funds may be used for homeownership. The Housing Commission has chosen to assist buyers directly rather than lending to developers, in most cases.

Advantages of Homeownership Activity:

- *Economic Effectiveness*
 - Homeownership shared equity loans feature a repayment of the Commission's loan funding. Principal is due to be repaid at sale or at the end of thirty years; no payments required until the loan is due. Instead of interest payments the Housing Commission receives a sliding scale share of the equity realized upon sale after deducting certain costs of home improvements. The Housing Commission's shared equity portion is "forgiven" if the home is not sold or transferred until after fifteen years.
 - Leverage of funds - first time homebuyer loans typically leverage private funds approximately four times the amount of the Housing Commission loan.
- *Neighborhood/Societal Benefits*
 - Helps stabilize neighborhoods and strengthen communities; homeownership is a commitment to the community. Homeownership enables people to have greater control and exercise more responsibility over their living environment.
- *Affordability Level and Certain Direct Benefits*
 - The City's Consolidated Plan identifies low-income households (31%-80% of median area income) as a high priority to receive first time homeowner services.
 - Helps working families purchase their first home.

- Gives families an asset that can grow in value and provide capital to finance college tuition and retirement.
- *Other Considerations*
 - There is a high demand for first time homebuyer loans and relatively fast implementation/occupancy by the homebuyer. A very strong local real estate market and lower interest rates have reduced the available pool of homes affordable to low-income buyers for purchase.

Disadvantages of Homeownership Activity:

- *Economic Effectiveness*
 - Current per-unit average subsidy (including Housing Commission average loan and average down payment assistance) is \$65,133, which is higher than some other activities.
 - In slower real estate markets, the Housing Commission second loan principal could be lost (in whole or in part) through foreclosure.
- *Affordability Level*
 - On average, assisted families earn approximately 67% of area median income (the HOME program allows up to 80% of area median income); which is higher than with other uses of funds.
 - Shorter term of affordability (when compared with rental).
- *Other Considerations*
 - If owner's income increases but the unit is not sold, there is no continued use by low income. If owner sells at market price, there is no guarantee that the unit will continue to be used by low income.
 - Beneficiaries are typically already living in safe, decent and affordable housing, albeit rental housing. Assistance may not be required for them to achieve minimal housing standards.

III. Rehabilitation of Rental and Owner-Occupied Housing - provides technical and financial assistance for the rehabilitation of privately owned housing occupied by low-income renters and homeowners. Non-categorical funds may be used for rehabilitation of both rental housing and owner occupied housing.

Advantages of rehabilitation of rental and owner-occupied housing:

- *Economic Effectiveness*

- The per-unit average subsidy for rehab activities is \$11,333, which is lower than the per-unit cost of other activities.
 - Some rehabilitation activity features a repayment of principal and a return on the Commission's loan funds (in the form of interest paid). In certain “targeted” areas of the City, loans to non-profit and for-profits rental owners are deferred for 10 years with zero interest and an option to extend deferment and affordability for an additional 10 years. Outside of targeted areas, non-profit owners of rental housing are eligible for Commission loan funds requiring residual receipts annual payments, with principal and 3% interest to be repaid at the end of 30 years.
 - Owner-occupied rehabilitation loans are available on a City-wide basis with zero interest deferred loans up to \$10,000 available to very-low income homeowners and 3 percent interest 15 year amortized and partially deferred loans up to \$35,000 available to homeowners up to 80 percent of Area Median Income.
- *Neighborhood/Societal Benefits*
 - Helps revitalize and stabilize neighborhoods.
 - Increases stock of standard affordable housing units by upgrading substandard housing units to Section 8 Housing Quality Standards and restricting rents for 10 to 20 years; maintains the stock of standard housing for low income homeowners unable to qualify for market rate loans.
 - Complements the City's Neighborhood Code Compliance efforts.
- *Affordability Level*
 - The greatest housing need identified under the Consolidated Plan is among very-low and low-income renters. Rental rehabilitation serves renters at or below 50% of area median income (very low-income). Homeowner rehabilitation, although available to homeowners with incomes up to 80 percent of AMI, actually serves families with incomes that average 32 percent of median.
- *Other Considerations*
 - Assists small developers and owner-occupants who cannot otherwise qualify for bank loans (most rental rehab projects have averaged four units).

Disadvantages of rehabilitation of rental and owner-occupied housing:

- *Economic Effectiveness*
 - Housing Commission funds normally cover the entire cost of rehabilitation, there is no leveraging.

- Some projects may fail, leading to defaults and potential loss of Housing Commission loan funds.

- *Other Considerations*
 - The rental program requires rent restrictions for ten years, which is not attractive to rental owners in the current high rent economy.
 - The complexity and nature of rehabilitation require a relatively long implementation period from proposal to tenant occupancy (slower than homeownership).
 - Lending to rental property owners raises the issue of possible "reward" for prior disinvestment.
 - The emphasis for the rehabilitation program is on small, quick rehabilitation "fixes" to resolve an immediate problem. While this focus allows more families to be assisted with limited funds, it does not bring the housing unit entirely up to housing quality standards.