State of California

LITTLE HOOVER COMMISSION

May 8, 2002

The Honorable Gray Davis
Governor of California

The Honorable John Burton
President pro Tempore of the Senate
and members of the Senate

The Honorable James L. Brulte
Senate Minority Leader

The Honorable Herb Wesson
Speaker of the Assembly
and members of the Assembly

The Honorable Dave Cox
Assembly Minority Leader

Dear Governor and Members of the Legislature:

California's housing crisis is largely of its own making – the escalating consequence of failed public polices that determine how communities grow.

The increasing housing shortage is so severe that it affects all Californians, and threatens to mute the State's economic potential. But the greatest burden for these failures is on the shoulders of the poorest Californians, those who cannot afford a home of any kind, or who live in substandard or overcrowded conditions.

More than 2.2 million low-income homeowners and renters in urban California are paying more for housing than they should, and as a result do not have enough left over for other necessities such as food, clothing or medical care. Among low-income renters, about two-thirds pay more than half of their income for housing and 91 percent pay more than the recommended 30 percent. Among low-income homeowners, more than three-quarters pay more than 30 percent of their income toward housing.

California has not built enough housing for more than a decade. To meet the needs of the growing population, state officials say that 220,000 housing units will need to be built every year between now and 2020. But between 1990 and 1997, only 91,000 units on average were produced each year. In 1999, when production was high nationally, fewer than 140,000 residential permits were issued in California. The shortage is greatest in the multifamily housing that could assist low-income families.

In the past, escalating prices were considered a mixed blessing. While buyers faced sticker shock, homeowners were quickly rewarded for their investment. The problem also was viewed by many as an unavoidable consequence of rapid economic and population growth.

The evidence now shows that the problem is chronic and getting worse. California is consistently under-building houses and apartments and the prices are so high in so many places that it threatens the viability of regional economies competing in a global marketplace.

The consequences go beyond housing and impact other important public policy goals, including the need to provide for the elderly, the disabled, and the mentally ill. Children without safe and stable places to live face additional challenges in school.

The evidence also demonstrates that California's housing shortage is not just the unwanted byproduct of prosperity, but the mounting consequence of failed policies. Researchers have documented that California has adequate land to build homes for residents well into the future – not by building on every inch of farmland and hillside, but by making thoughtful, inclusive and balanced growth decisions.

There is a growing acceptance that the State's separate and quota-based planning process for housing does not produce either the number of new units or the types of new or redeveloped neighborhoods that communities need, will accept and can afford. Similarly, it takes extraordinary entrepreneurs to cut through the regulatory and legal thickets that prevent many communities from restoring urban brownfields into new mixed-use neighborhoods.

While safe, decent and affordable housing is a concern for all Californians, most housing decisions are a matter of local control. The fact is that officials in cities and counties are charged with approving development projects, and the State has been reluctant to limit their discretion. And the reality is that these local officials will ultimately determine how well the State meets its housing goals.

Some local officials clearly are doing more than their fair share, while others are reluctant to meet the needs of their communities. And even those who are supportive of housing face enormous challenges. They must reconcile mandates for environmental protection and urban development. They must provide increasing services to more people without a rational revenue scheme. And they often face opposition from neighbors fearful that growth – particularly multifamily housing – will diminish their quality of life.

For its part the State establishes goals for housing, including affordable housing, and expects local communities to meet those goals. But the State also requires communities to comply with transportation and air quality mandates. And it imposes complex regulations to advance important social, environmental and economic goals. The State has established a taxation system that discourages new housing. But it also provides funds – from bond revenue for parks, schools, and water projects, to community development block grants – that support urban development. On the whole, some state policies support housing goals. Some of them are neutral to the housing goals. And some conflict with housing goals.

Each of these policies, however, is an opportunity for the State to assist, reward and even sanction local officials. In short, the State needs to be a stronger leader by using all of the available resources to ensure that all Californians have safe and affordable places to live.

The State must learn from local governments that are doing a good job, help those that need assistance and get tough with those who fail to perform. It must shift the focus of housing policy from planning for housing to making sure that housing gets built. It must actively help communities reconcile conflicting policies. And it should use every financial tool available to reward communities. Those that champion affordable housing should go to the front of the line for new funding.

To lower the risks and attract private capital for affordable housing, the State should foster public-private investment partnerships, increased certainty in the development approval process and the identification of new sources of private investment. And finally, the State should optimize available subsidies by making them reliable, consistent and easy to access.

This report is a call to action. It offers specific and practical recommendations that will help to increase the supply and reduce the costs of all housing – particularly affordable housing. It is not too late and the problem is not insurmountable.

Sincerely,

Michael E. Alpert

Michael E. Alpert
Chairman

Rebuilding The Dream:

Solving California's Affordable Housing Crisis

May 2002

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Executive Summary

Among the most basic of human needs is a place to call home. And nowhere in the United States is this need harder to satisfy than in California. The lack of affordable housing is so severe that it threatens the health and welfare of thousands of Californians, as well as the state's long-term prosperity.

As California's population has grown, housing production for most income levels has failed to keep pace. Escalating housing prices have put home ownership in many communities out of reach for middle income workers like teachers, firefighters and law enforcement officers.

But the impact of the State's housing shortage is felt most profoundly by low-income Californians who struggle to keep a roof over their heads. Among low-income renters, about two-thirds pay more than half of their income for housing and 91 percent pay more than the recommended 30 percent. Homelessness also is increasing, affecting approximately 361,000 Californians – more than 1 percent of the population.[1]

For those with the lowest incomes, an adequate supply of affordable housing can mean the difference between having a safe place to sleep and being homeless, between paying the rent or having adequate food, clothing and health care. For many, the housing crisis is putting beyond reach the "American Dream" in its most humble terms of safe, stable and secure housing.

An Immediate Opportunity to Build Low-Income Housing

The Commission was told by state housing leaders that an immediate opportunity exists to increase the stock of low-income housing in California.

There is a backlog of quality projects at the door of the Tax Credit Allocation Committee.

These projects have land, zoning, management and financing in place. The only missing piece is the equity from tax credits.

On average, only one in four projects that apply for Low Income Housing Tax Credits are awarded tax credits.

State officials said simply increasing the state tax credit would be insufficient to address the backlog. The federal tax credits are those most coveted by developers and are oversubscribed. Under current law, only projects that receive federal tax credits qualify for state tax credits.

Nevertheless, the State should make every effort to immediately clear the backlog of ready-to-go, low-income housing projects by subsidizing them with any available housing funds.

The Department of Housing and Community Development asserts that if current trends continue, California will build less than 60 percent of the new housing needed over the next 20 years.

In this project, the Commission explored how public policies could be reformed to fortify the State's ability to provide an adequate supply of affordable housing for the growing number of young families, newcomers, seniors and other Californians with low incomes.

A central tension in housing policy is created by California's strong tradition of local control and the statewide interest in an adequate supply of housing. Cities and counties adamantly defend their authority to make land use decisions. But the aggregate of those decisions increasingly fails to meet regional and statewide needs, particularly when it comes to housing.

What is Affordable Housing?

Housing is considered affordable when a monthly mortgage or rent payment is no more than 30 percent of income. So defining affordable housing requires a consideration of both income and housing costs.

California housing element law defines four income categories based on the percentage of an area's median income:

- Very low-income 0 - 50 %
- Low-income 50 - 80 %
- Moderate-income 80 - 120 %
- Above moderate-income 120 +%

For example, statewide in California, a very low-income household (earning $18,240 or 30 percent of the state area median income of $60,800) should pay monthly rent of no more than $456. But the fair market rent for a two bedroom unit is $957.

Affordability varies by region. In San Mateo County, a very low-income household (earning $24,840 or 30 percent of $82,800) should pay monthly rent of no more than $621. Fair market rent for a two bedroom unit is $1747.

In Fresno County, a very low-income household (earning $12,270, or 30 percent of $40,900) should pay monthly rent of no more than $307. Fair market rent for a two bedroom unit is $511.

A minimum wage earner (earning $6.25 per hour) can afford monthly rent of no more than $325.

In California, 47 percent of renter households (2.3 million households) pay more than 30 percent of their income for rent.

Sources: California Health and Safety Code Section 50052.5 and 50053; National Low Income Housing Coalition, *Out of Reach 2001: America's Growing Wage-Rent Disparity*.

Regional economies have evolved from cities and counties that in an earlier time functioned largely independent of one another. In the 21st century, economic viability and issues like transportation, air quality and housing transcend the boundaries of local governments.

Even where new housing is a priority, communities and regions must negotiate legitimate and inherent conflicts over social equity, environmental protections, inadequate infrastructure and fiscal responsibility. Californians have come to associate growth – particularly multifamily housing – with noise, traffic congestion, school overcrowding and other negative impacts on the quality of life. Affordable housing also competes with the desire for more open space, tax-rich retail development and other priorities.

Still, communities have more opportunities than they recognize or acknowledge. Communities can pursue partnerships to lower risks for developers, streamline review procedures and build community support for affordable housing. Without undermining Proposition 13, residents could approve a small surcharge for water and sewer fees to create a subsidy for low-income housing.

Local control also means local responsibility. Laguna Beach, for example, has virtually no developable land left and some of the state's highest real estate values, yet finds ways to make land available for affordable housing. "There are obstacles," said the city's director of community development, "But where there's a will, there's a way." [2]

The Commission also concluded that the State needs to seize every existing opportunity to encourage and help local governments make affordable housing happen. Every regulation, every requirement and every funding stream encourages local governments to act in certain ways. The challenge is to align those incentives with the development of affordable housing. Transportation funds, park bonds, housing bonds and all other funding streams with a nexus to urban development can be used as incentives. Communities that are meeting their performance goals should go to the front of the line. Communities that are unwilling to do their part should have a longer wait for limited funds. They also could lose discretion in how they spend existing funds, including redevelopment funds.

The State also should create new opportunities by helping communities to effectively and safely recycle brownfields for residential development. It can develop model zoning ordinances that encourage efficient and transit-oriented development and employ other strategies that will help local communities develop housing in ways that are economically, socially and environmentally responsible.

To overcome the barriers to the development of housing, the State needs a comprehensive public policy that does not dictate local land use decisions, but compels communities – with incentives, assistance, and sometimes penalties – to do their part in meeting the statewide need for housing.

The Commission has identified five important ways that state policies should be reformed to increase the supply of affordable housing:

1. The State should provide leadership and strengthen housing element law to make more land available for housing. It should refocus the law from planning for housing to ensuring that housing is built.

2. Public policies should be reformed to encourage greater use of urban “brownfields” for affordable housing, while enhancing the well-being, ensuring the health and safety, and encouraging the involvement of neighborhoods and residents.

3. The State should draw more investors into the market by accurately identifying and reducing the risks associated with affordable housing and identifying new sources of private capital.

4. Public subsidies – essential to providing low-income housing in an inflated market – should be consistent, reliable and efficiently allocated. Some infrastructure-related costs for affordable housing

should be reduced, shifted to the State or shared by the larger community.

5. State housing programs should be coordinated to make access to subsidies easier, streamline monitoring requirements and provide technical assistance.

The State has struggled to define a relationship with local jurisdictions that respects "local control" over land use decisions, while ensuring that housing is available for a growing population. The State has nudged, cajoled, and encouraged local jurisdictions to do their part. Many have responded, but many have resisted. The housing element law alone provides little incentive to comply and no consequence for failure to perform.

The Commission believes that the statewide interest and the needs of communities can be met with leadership and reforms that provide meaningful incentives for affordable housing, reduce barriers and provide technical assistance to implement effective strategies.

Toward these ends, the Commission offers the following recommendations. Some of the recommendations would increase the supply of all housing; the Commission identified others that would specifically increase affordable housing.

Land for Homes: From Planning to Performance

Finding 1: California does not have adequate state policies to ensure that local communities provide housing at all income levels, particularly for those at the lowest income levels.

For the private sector to supply an adequate housing stock at all income levels, local governments must adopt land use plans and regulatory schemes that provide opportunities for housing development and eliminate unnecessary constraints.

The state has a housing element law that requires cities and counties to plan for housing, including an adequate supply of affordable housing. In recent years, the law has become increasingly controversial among policy-makers, state and local officials and housing advocates.

Some cities, like Emeryville, recognize that housing is essential for sustaining and rebuilding communities. They have embraced affordable housing as part of a larger economic development strategy. Previously dubbed "the dirtiest town on the Pacific Coast," Emeryville has become a model for land recycling and has consistently built more than its "fair share" of housing.

Other communities have defied affordable housing requirements. Folsom, for example, built no low- or very low-income housing in a decade despite constructing more than 7,000 units of market rate and luxury homes and apartments. Housing advocates sued and a superior court judge imposed a moratorium on most development. In April 2002, the case was settled with Folsom agreeing to accommodate up to 2,900 low- and very low-income units. The city also has agreed to create a housing trust fund, impose an impact fee on nonresidential development and adopt an ordinance for emergency shelters.[3]

Two fundamental problems hinder the effectiveness of the housing element law. First, the law requires local governments to plan for housing, but contains no enforcement mechanism. There are few incentives to encourage reluctant communities to adequately plan and no meaningful consequences when they fail to do so.

Second, the focus of the housing element law is on planning rather than performance. So even when jurisdictions have plans approved by the State, local communities do not have to demonstrate that they have done their part to ensure that planned housing actually gets built. General plans are easily amended to accommodate specific projects, undermining on a project-by-project basis the long-term housing goals.

The system for allocating quotas and approving housing elements is controversial among communities. Absent an effective mechanism for resolving conflicts, disputed housing elements can result in years of costly legal battles between cities and counties and the State.

The State does not have a mechanism to track actual construction of new housing and compare that to local and regional quotas. Many local jurisdictions do not maintain data on residential building permits and even fewer track occupancy certificates, a more precise measure of performance.

Housing Element Components

By law, every local jurisdiction is required to update the housing element component of its general plan every five years and submit it for approval to the Department of Housing & Community Development. Each housing element must include:

- Review and revision of the prior housing element
- Housing needs assessment
- Land inventory by zoning type
- Governmental and nongovernmental constraints on housing
- Quantified objectives of housing units by income level
- Public participation, general plan consistency and other general topics
- Local housing program policies and goals

Source: Housing Element Review Worksheet, Department of Housing and Community Development.

Sonoma County

Until recently, Sonoma County has not had a certified housing element since its general plan was first adopted in 1989. Sonoma County argued that the number of housing units the Department of Housing and Community Development (HCD) set for the county as its regional "fair share" was too high, claiming it could not meet the requirement without rezoning rural properties for housing development.

Two years ago housing advocates filed a lawsuit against Sonoma County for non-compliance with the housing element law. Last August, a judge ordered the county to bring its housing element into compliance with state law.

In response to the legal action, Sonoma County revised its plan by identifying thousands of sites that were previously zoned for commercial or industrial uses.

After 10 years of negotiations and two years in court, HCD agreed to certify Sonoma County's housing element as long as the county agreed to annual reviews by the department.

Source: Santa Rosa Press Democrat, January 30, 2002.

Policy-makers have had trouble tying incentives or penalties to the housing element plan or housing production, with local governments asserting that incentives and penalties diminish their local control or limit access to funds they are entitled to receive.

At a larger scale, the State issues sometimes conflicting mandates, without providing a process, resources or technical assistance to solve them. Local policy-makers must resolve conflicts between requirements for wildlife habitat, agriculture, open space, water supply – and housing. When conflicts arise, policies often disfavor housing – to the detriment of low-income Californians. Housing needs should be given greater emphasis in resolving these disputes.

The State should enact policies to strengthen the housing element law and expand its focus from planning to performance. The potential for Regional Councils of Governments, which now allocate housing quotas, to play a more active role in ensuring local governments meet housing goals could be explored.

Recommendation 1: To make sure its housing goals are met, the State should implement a comprehensive set of planning policies and fiscal incentives to ensure that local jurisdictions effectively plan for and actually produce affordable housing. Specifically, the State should:

- ***Strengthen and enforce the housing element law.*** The Department of Housing and Community Development should clarify what is required of local jurisdictions, ensuring that the requirements of the housing element law are measurable, and standardizing the review and approval process. It should prepare a model housing element to assist local governments to comply with the law.

- ***Reform the housing needs allocation process.*** The State should reform allocation of housing requirements based on the recommendations of established working groups and implement a process to resolve disputes over allocation decisions. Once reforms are implemented, the State should sanction communities that remain out of compliance.

- ***Align conflicting policies.*** The State should reconcile state policies that conflict with its goals for affordable housing, including policies for environmental protection, agricultural and open space preservation, and water supplies. It should align time frames and planning processes for transportation, air quality and housing and establish a venue to resolve conflicts. The development of housing, especially affordable housing, should be given greater emphasis.

- ***Provide fiscal incentives.*** The State should link future funding sources – such as transportation funds and proceeds from park or other bond measures – to a community's progress toward meeting its housing goals. It should identify funding sources that communities want and that would be effective incentives to produce housing. The State should pursue agreements with COGs and local governments in their regions on a set of incentives and penalties that are best aligned with local circumstances.

- ***Track performance.*** The State should develop a statewide database to track construction of new housing and compare it to housing element plans. COGs should assist cities and counties to track building permits and occupancy certificates and report the data to the State.

Empowering Councils of Governments

The State should explore opportunities to enlist Councils of Governments (COGs) as partners in accomplishing statewide and regional goals for housing. It should consider a system in which regional housing goals influence housing funding decisions – similar to the transportation planning and funding process.

Transportation policy and funding decisions evolve around a regional planning process where priorities and goals are established at the local and regional levels and are aligned with funding decisions.

COGs perform the state-mandated Regional Housing Needs Assessment – essentially a housing market and needs analysis. But there is little connection between that process and the allocation of funds to support the identified needs for affordable housing.

If COGs were given the authority to influence performance, outcomes could be improved. Specifically, the State should consider expanding the role of COGs to include:

- ✓ Working with cities to assure the State that there are adequate sites to meet regional needs.
- ✓ Allocating some housing funds based on regional needs and goals.
- ✓ Working with cities to transfer quotas when more affordable housing can be produced closer to jobs.
- ✓ Rewarding cities that accept higher allocation numbers.

Such a system would align planning and funding processes for affordable housing and integrate transportation, housing and other regional planning issues.

Roles for the State under such a system that have been suggested include review and approval of regional plans and participation with the COGs in funding decisions.

Sources: State Affordable Housing Resources: The Case for a Regionally-Based Allocation System, discussion draft, revised August 14, 2001, Southern California Association of Governments, Department of Planning and Policy, Community Development Section. Personal Communications: Mark Pisano, Rusty Selix, DeAnn Baker.

- ***Provide guidelines and technical assistance.*** The State should provide guidelines and technical assistance to help communities resolve conflicts and plan for and implement innovative strategies for affordable housing. It should utilize the expertise of the University of California to establish model zoning ordinances and best practices, including, for example, in-law housing and parking requirements for multifamily housing.

Land for Homes: Restoring Brownfields

Finding 2: Urban brownfields are an undeveloped opportunity to make land available for affordable housing close to job centers, break the cycle of deterioration and enhance the well-being of surrounding neighborhoods.

Typically concentrated in older urban centers, brownfields represent an untapped opportunity to increase the supply of land available for housing in urban areas. Brownfield revitalization also can boost sagging local economies with new jobs, increased tax revenues and improved health and safety. It is estimated that there are over 90,000 contaminated sites in California. [4]

California has enacted legislation in recent years to clarify the roles of state and local agencies in brownfield redevelopment and provide fiscal and regulatory incentives for developers and communities to clean up contaminated sites. But fundamental problems remain.

- ***Fragmented oversight.*** State oversight authority for brownfields cleanup remains fragmented among myriad federal, state and local entities and regulations, increasing the "red tape" and driving up the costs of developing these sites.

- ***Uncertain cleanup standards and liability.*** Uncertain cleanup standards and the liability imposed by federal and state regulations and policies have inhibited investment in these properties and hastened the retreat of investors to cheaper and safer

State Brownfield Programs

Cleanup Loans and Environmental Assistance to Neighborhoods (CLEAN). Established in 2000 by the Legislature and administered by the Department of Toxic Substances Control, the CLEAN program provides two types of grants and low-interest loans that can be used for preliminary site assessment and site cleanup. Six communities have received $5.5 million in loans for commercial and industrial redevelopment, low-income and market rate housing, mixed-use development and downtown revitalization.

Cal ReUSE. Recent legislation authorized the California Pollution Control Financing Authority (CPCFA) to establish a program to provide grants and loans for the identification, assessment and mitigation of brownfield sites. CPCFA has set aside $10 million for the Cal ReUSE program. Loans totaling $2.3 million have been committed to three communities, Oakland, San Diego and Emeryville, to assess contamination and determine the potential of brownfield sites.

Traditional economic development tools available for brownfield funding include: Redevelopment Agency Tax Increment Financing, Mello-Roos Bonds and State Enterprise Zones

Sources: Legislative Analyst's Office Analysis of the 2002-03 Budget Bill; Edith M. Pepper, *Strategies for Promoting Brownfield Reuse in California--A Blueprint for Policy Reform*, California Center for Land Recycling, October 1998.

"greenfield" developments. Recently enacted federal legislation will provide liability relief for small businesses and prospective purchasers of brownfield sites and grants for site assessment and cleanup.[5]

- **_No inventory._** There is no requirement that jurisdictions or property owners specifically identify and disclose information about the existence of brownfields, the extent of their contamination or potential for reuse. As a result, there is no state repository for information on the number of abandoned urban properties statewide or their potential for increasing the supply of affordable housing or restoring communities.

With few exceptions, California lags behind states like Pennsylvania and New Jersey that have streamlined regulatory procedures, set standards for cleanup based on the intended use of the property and effectively shielded developers from liability.

The handful of effective California brownfield programs are largely the product of innovative local leaders who refuse to be deterred by the confusing bureaucracies and regulatory barriers. But few communities have leaders with the vision, creativity and political will to tackle the obstacles to brownfield development as a primary strategy to advance affordable housing.

A key factor in the success of local brownfield efforts is the willingness to effectively engage and provide the community with the opportunity to influence the redevelopment process. Effective community involvement can ensure that brownfield redevelopment meets the needs of residents and improves a neighborhood's well-being.[6]

Successful Brownfield Redevelopment

Emeryville

- **One-Stop-Shop Web site.** Provides online information by parcel on contamination status, zoning and density for all sites within the city.
- **Technical Assistance.** The city provides assistance to developers to help navigate the state regulatory process. Its Web site offers developers guidance on federal brownfield tax incentives and links to informative sites.
- **Loans.** Low-interest loans are available for site assessment and cleanup.
- **Redevelopment Agency.** High priority sites are acquired and cleaned up. The agency seeks recovery of costs and resells the certified sites to developers with specific development/land use objectives.

In 1996, Emeryville received a Brownfield Pilot Project grant from the U.S. EPA. The city also has tapped into redevelopment agency funds and the State's new Cal ReUSE loan and grant program.

According to the California Center for Land Recycling, 92 percent of the sites being cleaned up are the result of public/private partnerships. The State should aggressively promote the reuse of these sites for affordable housing – and other economic development opportunities – by establishing policies and providing incentives to engage communities, reduce risk and attract public and private investment. The State should facilitate brownfields programs in all affected communities, but particularly in those that fail to meet affordable housing goals.

Recommendation 2: California should seize the opportunity that urban brownfields present for increasing the supply of affordable housing by establishing policies and incentives that prioritize the reuse of these sites. The State should:

- ***Require local jurisdictions to identify potential sites.*** Cities and counties should identify and characterize potentially contaminated infill sites where affordable housing could be developed and publish an online inventory of sites. Local inventories should be reported to the State and identified in housing elements.

- ***Establish a statewide database.*** The Department of Toxic Substances Control should assemble the information developed locally into a statewide database. The database should be used to determine how much of California's housing demand could be met by redeveloping sites and where recycling would provide the greatest opportunities for increasing the stock of affordable housing.

- ***Develop state guidelines and streamline the approval process.*** The State should establish guidelines for cleanup that are based on the intended use for the site. Guidelines should provide regulatory certainty and protection from protracted and costly litigation when environmental impacts and other conditions have been met. Additionally, the State should provide local governments a clear definition of brownfields, and simplify and "fast track" the approvals process.

- ***Provide financial and technical assistance.*** The State should increase grants, loans and proceeds from housing bonds to local jurisdictions and private developers for site assessment and inventory development. Priority for funding should be given for sites that could be zoned for housing. The Department of Toxic Substances Control should conduct educational conferences and provide technical assistance to redevelopment agencies, cities, and counties to accomplish goals for brownfield development, including improving the capacity of communities to elicit public participation in decision making regarding redevelopment projects.

Should the State Buy and Clean Up Brownfields?

It has been suggested that the State consider buying and cleaning up some of California's brownfields as a way to advance the reuse of sites that are particularly difficult to market.

The State could use bond issues to buy and clean up land, then lease it to developers for affordable housing. By scheduling the rents appropriately, the State could use any excess cash flow to repay the bonds.

The State also could sell sites it has cleaned up and provide liability protection to the new owners. Whether the State could recover its costs would depend on the State's capacity to prudently buy land, clean it up, negotiate with developers and other factors.

The Commission has not examined these options, but believes they are worth exploring.

- **Audit progress.** The Department of Toxic Substances Control should review and issue "report cards" on the progress of local jurisdictions in meeting goals for brownfield development. The department should focus first on those communities with the greatest number of brownfields and largest need for affordable housing.

To Lower Risk and Attract New Capital

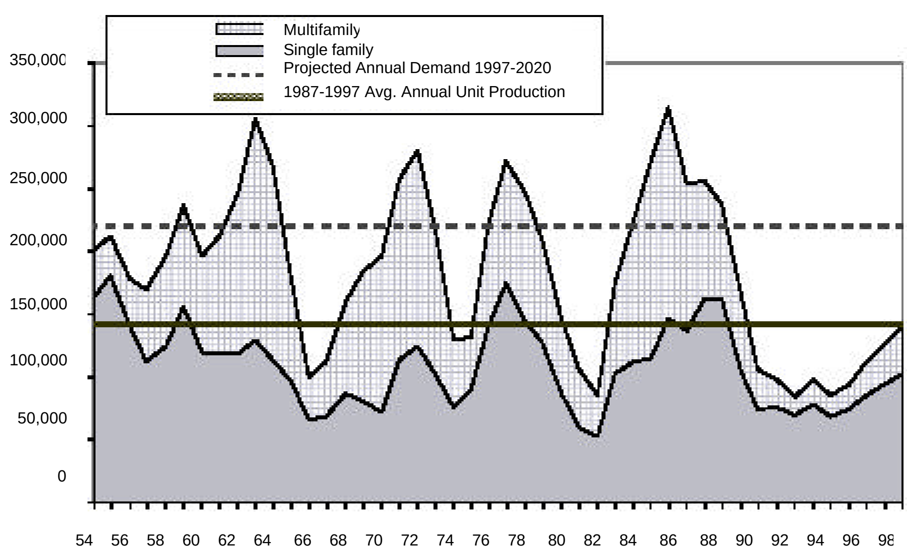
Finding 3: Diminished investment incentives, coupled with uncertainty and perceived risk, have quashed private investment in affordable housing – particularly multifamily housing.

For many developers, the uncertainty and high costs of the development approval process combine to make multifamily housing projects a high-stakes gamble.

A key incentive for private investment in multifamily housing disappeared with the enactment of the Tax Reform Act of 1986. From 1986 to 2000, the number of permits issued for multifamily housing fell from 45 percent to 25 percent of total residential permits issued – a decrease of more than 112,000 units. [7]

The vast majority of private capital invested in affordable housing comes from the banking industry as a result of the Community Reinvestment Act (CRA), which requires banks, thrifts and other lenders to invest in low- and moderate-income neighborhoods. Large institutional investors such as pension funds and insurance companies also are considered

California Residential Permits, 1954-



Source: *Raising the Roof*, California Department of Housing and Community Development.

potential sources of capital by policy-makers, but have been reluctant to participate. Recently, the Public Employees Retirement System and State Teachers Retirement System made commitments to invest in affordable housing.

Since Proposition 13, development fees and exactions have further increased the cost of housing, making it even more difficult for affordable housing to "pencil out." California leads the nation in imposing fees on new residential development, with cities and counties typically charging more than two dozen types of fees to cover the costs of planning, infrastructure and serving new developments. Fees average $20,000 to $30,000 per unit and account for more than 15 percent of new home prices in jurisdictions providing affordable housing.[8] A Bank of America representative described a loan for a $16 million project with loan fees of $1 million and impact fees of $1.6 million.[9]

Still, there are opportunities for the public sector to increase private investment and lower costs by reducing risk and spreading the responsibility for serving low-income homes.

Smart Permit Project

The Smart Permit Project was started in 1994 by Joint Venture: Silicon Valley Network to improve the development, review and permit process in cities and counties in the region by streamlining, automating and Internet-enabling the building permit process. Eight cities now have Web-enabled permit systems which allow property owners, contractors and businesses to check the status of their permits, submit plans electronically and apply and pay for permits online.

The Community Capital Investment Initiative in the Bay Area – a public-private-community partnership – has reduced risk by pooling funds, providing leadership and building capacity locally.

For developers, time is money. The Smart Permit Program – a permit streamlining project among cities in the Silicon Valley – is a model that could be adapted by communities statewide to reduce the costs and risks associated with affordable housing projects.

The experiences of institutional investors like Bank of America, Washington Mutual and others attest to the potential affordable housing investments have to provide acceptable – and competitive – rates of return.

The State should promote and support these types of strategies to reduce risk and attract capital investment in affordable housing.

Recommendation 3: The State should implement policies and promote practices to increase private investment in affordable housing. Specifically, the State should:

- ***Promote partnerships.*** The State should educate leaders from the public and private sectors about the potential of partnerships like the Community Capital Investment Initiative in the Bay Area to lower conflict, share risk and cost, and increase available capital. It should assist local and regional government officials to develop the skills and expertise to develop similar partnerships among businesses, residents, other local officials, and state and federal agencies.

- ***Increase the efficiency and certainty of the project approval process:***

  - ✓ Local jurisdictions should be encouraged to consolidate fee schedules, develop one-stop permit centers and provide for online review of projects.

  - ✓ Local jurisdictions should be encouraged to extend payments for development fees over time to reduce the present-value costs that inflate the bottom line of housing projects and burden homebuyers and renters.

  - ✓ The State should set standards for establishing fees as a way to reduce and rationalize their costs.

- ***Identify new sources of capital.*** The State Treasurer should convene a task force to identify new sources of private capital for investment in affordable housing. The task force should recommend a strategy for outreach and education about the financial and social returns achievable from affordable housing investments. Participants should include banks, insurance companies, pension funds, state housing agencies, the Business Roundtable, housing developers and advocates.

Subsidizing Affordable Housing: Making the Most of Available Subsidies

Finding 4: Public subsidies for affordable housing are inconsistent, unreliable and are not allocated in ways that provide the greatest value.

High development costs and low returns on affordable housing make it virtually impossible to develop affordable housing without subsidies.

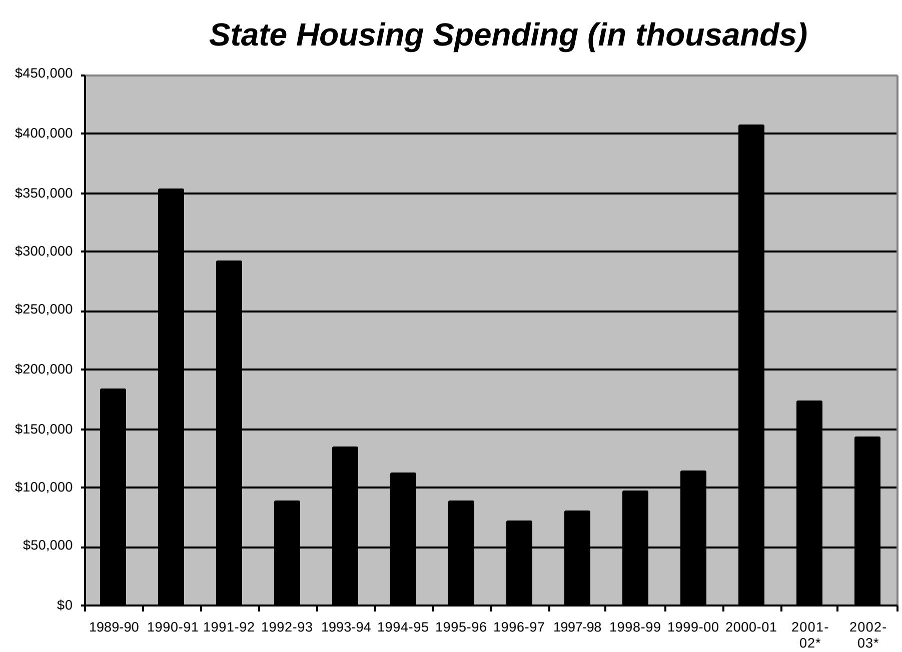
Affordable housing is subsidized in a variety of ways, including federal and state grants and loans, tax increments from redevelopment agencies, private investment – largely from the Community Reinvestment Act activities of banks – and through quota requirements placed on new development. But the funding has been inconsistent and unreliable, greatly frustrating efforts to build affordable housing in California.

Federal subsidies, still the largest source of funding for affordable housing, have declined dramatically. And state support has fluctuated wildly depending on the State's fiscal conditions and political priorities.

The lack of predictability and consistency has compromised the ability of housing officials to adequately plan for and administer programs. In some instances costly efforts to gear up for new programs have been wasted when budget cuts resulted in their premature demise. Sometimes, funds are redirected when political priorities change. Large funding increases in 2000-01 quickly fell victim to the 2001-02 fiscal crisis.

The California Housing Trust Fund, established in 1985, was intended to be a consistent funding source for state housing programs. But the fund receives less than $2 million annually. Other states have had much greater success with trust funds. In Florida, for example, a documentary stamp tax provides $120 million a year to its housing trust fund.

Approximately a dozen local housing trust funds exist in California, with Santa Clara, Sacramento and San Diego among the most notable. Major local initiatives are underway in San Mateo and Los Angeles. But the



Source: California Budget Project; * 2001-02 estimated (includes midyear reduction); 2002-03 proposed.

State has not provided leadership to encourage more widespread implementation of these efforts.

State subsidies are allocated largely on the merit of the individual project. In making awards, little consideration is given to how the project will address local and regional housing needs, as reflected in local and regional planning processes mandated by the State.

Redevelopment agencies, the largest source of funding for affordable housing after the federal government, are required to spend 20 percent of their property tax revenues on low- and moderate-income housing. But approximately 200 of the 800 redevelopment areas statewide are facing expiration of their time limits. Recent legislation permits redevelopment agencies to extend their time limit and continue to receive tax increment revenues when certain conditions are met.[10] Policy-makers and advocates also have proposed that redevelopment law be amended to increase the set-aside required for affordable housing.

When citizens have decent, safe and affordable housing, the entire community benefits. But since Proposition 13, the latest generation of homeowners, rather than the entire community, shoulders the cost associated with affordable housing.

Finding 3 described how development fees drive up the cost of all housing and suggested ways to rationalize and reduce the risk and cost to developers. If some fees for developments meeting specific criteria for affordability were shifted to the State and shared by the community, development costs for those projects could be reduced even further.

Some agencies are revisiting the costs of providing infrastructure-related service, resulting in lower fees for infill developments. Others are thinking about how to use surpluses to subsidize low-income housing.

Having declared affordable housing an issue of statewide importance, the State should ensure consistent and reliable sources of funding to support its goals. Recognizing the community-wide benefits of affordable housing, the State should implement strategies that permit the broader community to share some of the costs for affordable housing.

Economic Development Bank

Sacramento Regional County Sanitation District developed an Economic Development Treatment Capacity Bank of sewer impact fee credits. It offers reduced fees for local jurisdictions to encourage economic development for industrial, commercial and residential projects.

The “bank” came from excess capacity the district purchased from four local industries. It converted the capacity to 16,000 “estimated service demands.” (One ESD is the equivalent service needed for a single-family dwelling.) The district valued each ESD at $920 each, “banked” them and made them available for economic development purposes. (The market rate fee for one ESD is currently $3,500 and is expected to exceed $5,200 in 2002.)

Developers can apply for the credits. District staff says this reduces costs for developers and allows the district to more accurately plan future facilities.

The project is an example of how infrastructure agencies can do their share to lower the costs of low-income housing.

Recommendation 4: The State should identify permanent, dedicated sources of funding for the California Housing Trust Fund, promote local housing trust funds and enact policies to share infrastructure-related costs for affordable housing. Specifically, the State should:

- ***Identify a permanent, dedicated source of funding for the California Housing Trust Fund.*** Revenue sources that could be considered include: portions of real estate transfer taxes, document recording fees, bank and corporation taxes, interest from real estate escrow accounts, and others. The State should promote the establishment of local housing trust funds and give priority for state trust fund allocations to jurisdictions with matching local trust funds.

- ***Shift infrastructure costs.*** The State should pay portions of infrastructure costs for affordable housing projects meeting specific criteria, in areas with the greatest needs. For example, future school bond measures could include a fund to pay the local school impact fees for affordable housing projects. Other mechanisms could include returning an increased share of sales tax revenue to jurisdictions that reduce development fees, providing Infrastructure Bank loan incentives for jurisdictions that reduce fees, or earmarking fines from EPA enforcement actions with a nexus to infrastructure. It could exempt from school impact fees affordable projects serving populations, like seniors, that do not access schools.

- ***Spread infrastructure costs.*** The State should explore ways to spread infrastructure costs associated with low-income housing developments to the larger community.

- ***Allocate subsidies efficiently.*** As COGs play a larger role in advancing housing goals, regional planning processes and statewide needs should influence how housing funds are allocated. Decisions regarding funding should be coordinated among state agencies and COGs.

- ***Focus on tax credits.*** The State should more aggressively advocate for additional increases in the federal tax credit program. To immediately increase the supply of affordable housing, the State should allocate any increases in state funding for affordable housing to qualified projects that are ready to begin construction but are constrained by the limited supply of tax credits.

The Housing Bond: Evaluating its Effectiveness

The State did not conduct an analysis of the impact of the three housing bonds passed between 1988 and 1990. If the voters approve the proposed $2.1 billion housing bond in the November 2002 election, the Legislature should require a rigorous, independent evaluation of its effectiveness. Specifically, the evaluation should provide an analysis of who received the funds, the impact of the funds on specific projects and the statewide housing shortage, and provide policy makers with guidance for the use of future housing bond funds.

Subsidizing Affordable Housing: Making Subsidies Easy to Access

Finding 5: Developers of affordable housing must patch together funding from multiple and disparate sources, delaying development and increasing costs.

Nonprofit developers, the State's largest producers of affordable housing, commonly require 10 to 12 public and private funding sources per project. One developer reported using 22 sources for a single project.[11] The process of identifying available funding sources, submitting multiple applications, and meeting the different requirements is labor intensive and costly.

Three state agencies administer most state housing programs. Fragmentation – including multiple applications, different funding cycles and rules, changing scoring criteria and redundant monitoring – increase the time and cost involved with securing federal and state financing and maintaining projects. One developer said that state agency applications can often be 300 pages long and described the process as a "colossal waste of time for us and for the State."[12]

Even so, by all accounts, state agencies now work more cooperatively than ever before. The director of the Department of Housing and Community Development told the Commission that the coordination described by the Housing Task Force in its 1997 final report to the Legislature has been maintained and enhanced.[13] Agencies have a memorandum of understanding to meet regularly and coordinate activities. They are attempting to coordinate compliance monitoring and have made some progress to improve coordination of funding cycles.

The customers of these agencies – nonprofit and for profit developers – agree that important improvements have been made. They also concur that more remains to be done to streamline the application process, better align funding cycles and coordinate compliance monitoring. A representative of one state department said that additional efficiencies would not significantly reduce state administrative costs. The goal of these efficiencies, however, should be to increase the supply of affordable housing by reducing the time and costs to developers in accessing funding and maintaining projects. An important but secondary benefit could be some administrative cost savings for state agencies.

State officials assert that because the programs have different purposes and goals, coordination is difficult. Additionally, the Tax Credit Allocation Committee must abide by federal requirements, while CHFA and HCD have more flexibility to make their own rules.

Many of these arguments have merit. The programs were established independently, are complex and have different functions. Within the departments, separate and distinct organizational practices and cultures have evolved. But differences and difficulty should not be excuses for maintaining the status quo. When business-as-usual complicates the efforts of producers of affordable housing to efficiently access state resources, reforms are in order.

The State should provide leadership for reforms that will ensure continuous improvement in services to affordable housing developers. It should provide information and technical assistance to advance the housing goals of local communities.

Recommendation 5: The State should enact policies and practices designed to facilitate easy access to affordable housing resources. Specifically, the State should:

- ***Streamline the administration of state programs.*** The Governor and Legislature should direct the Department of Housing and Community Development, California Housing Finance Agency and the Tax Credit Allocation Committee to further coordinate their activities to provide more efficient and effective services to entities that access their programs. The agencies should strive for continuous service improvement and initially consider the following reforms:
  - ✓ A simplified "core" application for housing production programs with attachments, as necessary, for specific programs.
  - ✓ A "lead" agency and single point of contact responsible to coordinate and guide all applicants accessing more than one program.
  - ✓ Alignment of funding cycles.
  - ✓ Accelerated, concurrent and cooperative application review.
  - ✓ Consistent rating criteria.
  - ✓ Coordinated or consolidated compliance monitoring.

- ***Review progress.*** HCD, CHFA and TCAC should annually report to the Governor and Legislature their progress toward improved cooperation, coordination and service delivery. The departments, in consultation with developers and housing advocates, should identify performance indicators to measure progress, including time and resources required to secure funding, access to information and technical assistance, and compliance monitoring requirements.

- ***Establish a clearinghouse.*** The State should establish an affordable housing clearinghouse in the Department of Housing and Community

Development to provide “one-stop shopping” and technical assistance. The clearinghouse should:

- ✓ Maintain an inventory of private and public sources of funding for affordable housing.
- ✓ Pursue ways to align federal, state, local and private funding sources.
- ✓ Provide training and technical assistance to help developers more effectively and efficiently secure project funding.
- ✓ Provide training and technical assistance to local and regional governments on how to align housing and transportation policy and funding.
- ✓ Assist local communities to develop public-private partnerships.

Introduction

During the past decade, the California population grew by more than 4 million people. Many of those newcomers are our children, who need safe places to live now, are crowding into schools and will soon be looking for jobs and homes of their own. Much of that growth is attributed to people moving into California – mostly young workers with families drawn by the vibrant economy.

Housing, however, has not kept pace with the growth in jobs, workers and their families – resulting in a critical shortage of adequate housing. This shortage is most severe and has the greatest social consequences at the lowest income levels, although in parts of California even middle-income workers struggle to find housing near their jobs and within their budgets.

The Commission initiated this study because it recognized the potential for this problem to undermine many other public goals. It also recognized that despite considerable debate among policy-makers, the shortage is growing worse. Housing prices are no longer a cyclical challenge for Californians, but a worsening problem with economic and social consequences for individuals, employers, communities and regions.

In 1995, the Commission conducted a comprehensive examination of land use policies. It advocated streamlining the environmental review process and encouraged regional strategies for land use and infrastructure planning – issues that directly impact the availability of affordable housing. In more recent years, the Commission has examined a variety of programs, and understands how the shortage of housing frustrates everything from attracting a workforce of high quality teachers to helping people live independently with mental illness.

Due to the complexity of the issue, the Commission focused on three areas: 1) how the State could help make more land available for housing and encourage local governments to ensure that adequate affordable housing is built; 2) ways to increase private investment in affordable housing; and, 3) ways to improve the efficiency and the impact of housing subsidies.

As part of this study, the Commission conducted three public hearings, receiving testimony from State housing leaders, local government representatives, advocates for low-income housing, building industry experts, for-profit and non-profit developers and private investors. These individuals addressed the barriers and explored with the Commission opportunities to advance the State's affordable housing goals. The witnesses are listed in Appendix A.

The Commission convened an advisory committee comprised of affordable housing stakeholders representing a diverse group of interests. The advisory committee met three times to help Commissioners understand each of the issues under review. Advisory committee members are listed in Appendix B.

To better understand how State policies affect efforts by local governments, the Commission toured projects in the City of Richmond and met with local redevelopment leaders. Additionally, the Commission met with executives from the three of the largest non-profit builders to discuss constraints and potential solutions. The Commission also met with the Federal Reserve Bank of San Francisco to explore ways to increase private investment in affordable housing.

The study confirms that the underlying causes of the affordable housing crisis are many and that there is no one simple solution. Still, the recommendations in this study – to strengthen and enforce the Housing Element Law, to expand its focus from planning to performance, to reduce the risks associated with affordable housing and to make subsidy programs reliable, efficient and easy to access – would advance the State's goals of decent housing and a suitable living environment for every Californian.

This Introduction is followed by a Background, which details the scope of the problem and identifies emerging trends and opportunities. The Background is followed by five findings and recommendations.

Background

California's housing shortage has resulted in escalating home prices and skyrocketing rents. While dramatic increases in property values are a boon to homeowners, those at the bottom tier of the housing market are spending more of their income on housing. Even worse, many Californians with low- and very low-incomes are simply priced out of the market, and onto the street.

While housing availability is only one cause of homelessness, it also is only one social and economic consequence of the housing crisis. As low- and moderate-income wage earners spend more on basic shelter, they have less to spend on other necessities. Very low-income households may spend 70 percent of their earnings on rent, leaving little to pay for food, health care and other basics.

Overcrowding rises as large families settle for small homes and families double up. Workers move farther and farther from their jobs – increasing traffic congestion and pollution, while decreasing their time with family and in their community. Employers spend more money attracting and retaining employees and are tempted to relocate to other states.

Losing Ground

Put simply, there are more people in California than there are places to live. The 2000 Census found just under 34 million people living in California, a 13.6 percent increase from 1990. The state Department of Finance projects growth will continue through the next 20 years, resulting in 40 million residents by 2010 and 45.5 million residents by 2020. These population figures translate into an additional 3 million households by 2010 and over 5 million additional households by 2020.[14]

Meanwhile, housing production has lagged population and job growth throughout the past decade. The year 2000 marked the 11th consecutive year that housing production in California fell well short of the annual need.[15] Additionally, the housing that is being built is often not located close to job centers and other areas where it is most needed. To meet the projected future demand, California homebuilders would have to construct an average of 220,000 housing units every year for the next two decades. Between 1990 and 1997 annual production of housing as measured by statewide residential building permits averaged a mere 91,000 units. In 1999, when national housing production was high, less than 140,000 residential permits were issued in California.[16]

Crisis of Affordability

The inadequate supply and the increasing demand for housing has pushed prices through the roof. In 2001 alone, the fair market rent for a two-bedroom apartment increased 23 percent and the price of homes increased by 16 percent on average across the state.[17] For most California families, housing constitutes their single largest expenditure.

The U.S. Department of Housing and Urban Development (HUD) defines affordable housing as housing which costs no more than 30 percent of a household's income. Among low-income renters in metropolitan California communities, nearly two-thirds pay more than half of their income for housing and 91 percent pay more than the recommended 30 percent. More than three-quarters of low-income owner households pay more than 30 percent of their income toward housing.[18]

California's homeownership rate is the second lowest in the nation. Less than 56 percent of Californians own homes, compared to a national average of 67 percent.[19] Nine of the 10 least affordable housing markets are in California, according to a recent survey by the National Home Builders Association.

Who Is Affected?

A very large proportion of California families – both renters and homeowners – cannot afford to pay the rising cost of housing. These families fall into moderate, low-income and very low-income categories. For moderate-income families, this often translates into not being able to afford a home close to employment or delaying home ownership until later in life. In parts of the Bay Area, many moderate income workers such as teachers, public safety personnel, retail workers and clerical employees cannot afford to live in the cities where they work.

For low- and very low-income families, it means living in overcrowded conditions, substandard housing or perhaps even homelessness.

In 1998, the most recent year that data is available, 411,758 Californians received some type of rental assistance from HUD.[20] None of

Rents Out of Reach in Silicon Valley

Santa Clara County is just one example of the affordable housing crisis. The fair market rent for a two-bedroom apartment in 2001 was $1,592, which would only be affordable to families earning at least $63,680 per year and would take the salaries of five minimum wage jobs to achieve. Across the State, the average 2001 fair market rent for a two-bedroom unit was $957, a level affordable to families earning $38,280.

Source: National Low Income Housing Coalition, *Out of Reach*, 2001.

the federally subsidized housing authorities in California's major urban areas, as well as many rural and suburban areas, have enough housing to meet demand. Waiting lists are huge and it often takes as long as eight years to get to the front of the line.

Officially, there are 371,740 families on waiting lists for one of the 104,113 units subsidized by the Housing Certificate Fund (formerly called Section 8). The HUD public housing program has only 25,268 units, but 93,632 families waiting for units to be available.[21]

In addition to those programs, the federal and state governments provide housing subsidies to special populations, including seniors, farmworkers, the developmentally disabled, Native Americans, people with AIDs, those living in mobile homes and the homeless.

Within each special population, a varying number of constituents qualify for assistance. Because each federal and state program has different requirements, it is difficult to quantify how many people within each category are being served and even harder to quantify how many people could qualify for programs but do not apply for or receive assistance.

Seniors – According to the most recent census, there are 3.6 million Californians over the age of 65. About 29 percent of seniors who own their own home spend more than 30 percent of their income on housing. About 71 percent of low-income senior homeowners spend more than 30 percent of their income on housing.[22]

Seniors on fixed incomes who rent are the most critically affected by the housing shortage. About two-thirds of senior renters pay more than 30 percent of their income toward housing. Of the seniors who are low-income and rent, 85 percent pay more than 30 percent of their income on rent.[23]

Farmworkers – California's farmworkers have unique housing needs. Nearly half of the farmworker families live in the San Joaquin Valley. During the peak of the season, there are 860,000 farmworkers requiring housing, representing a total household population of 1.35 million people. Farmworkers have the second lowest rate of homeownership of all occupational categories in the nation.

During the past decade, registered housing for migrant farmworkers has declined by a third from 1,414 units in 1982 to only 500 units in 1998. As a result, many farmers have replaced registered facilities with converted garages or sheds, which often lack plumbing. Increased rents during peak harvest months often force farmworkers into overcrowded motel rooms. A 1995 study by the University of California, Davis, estimated that 250,000 farmworkers and their families lived in inadequate housing.[24]

Developmentally Disabled – There are approximately 170,000 people with developmental disabilities living in California. Of these, nearly 80,000 are over the age of 18. Almost 67 percent of adult Californians with developmental disabilities live in the home of a parent or guardian, many of whom are elderly. Those who choose not to live with family, in a state hospital or a group home, must find housing with significant subsidies to fill the gap between their limited Social Security incomes, often as little as $635 per month, and the cost of rent. [25]

Native Americans – Native Americans represent another segment of the population that is eligible for specific housing subsidies. The Native American population is 333,346, according to Census data.

People with AIDs – People with AIDs also may receive government subsidies. Housing programs are primarily targeted at persons who are homeless or those at great risk of homelessness. The Department of Health Services estimates that 124,000 Californians have AIDs.

Residents in Mobile Homes -- The State also addresses the needs of residents of mobile homes through programs that help unite mobile home owners in parks that may be sold. The State assists the formation of owner associations to purchase properties to maintain affordability. There are 539,000 mobile home units in California.

The Homeless – Perhaps one of the hardest populations to quantify are the homeless. Most studies estimate the homeless population to be at a minimum of 360,000, approximately 1 percent of all people in the state. About 35 percent of homeless people are part of a homeless family.[26] There is much discussion about how many people choose to be homeless, and about other contributing factors, including mental illness, substance abuse and economic problems.

A recent study by the Public Policy Institute of California found a greater incidence of homelessness in California cities with the greatest disparity between rents and incomes. The institute also found that the increasing inequality of incomes has increased the demand for, and therefore the price of, the lowest-quality housing, forcing out the lowest-income renters.[27]

State Interest vs. Local Control

The State's goal is to ensure that decent housing is available for all Californians, however, it has exerted limited authority in pursuit of this goal. The State has enacted laws that require local jurisdictions to accommodate housing development. The State also administers and funds programs to accomplish its objectives. Still, the State grants wide discretion to cities, counties and redevelopment agencies and so is largely dependent on the actions of local governments.

The housing element law is the primary vehicle through which the State directs housing policy. The law requires local jurisdictions to plan for an allocated number of housing units at various income levels based on data provided by the Department of Housing and Community Development and the regional Councils of Governments (COGs).

State Housing Law

The State's policy goals are explicit:

The availability of housing is of vital statewide importance, and the early attainment of decent housing and a suitable living environment for every Californian, including farmworkers, is a priority of the highest order.

The provision of housing affordable to low- and moderate-income households requires the cooperation of all levels of government.

Local and state governments have a responsibility to use the powers vested in them to facilitate the improvement and development of housing to make adequate provision for the housing needs of all economic segments of the community.

Source: Government Code Section 65580-65589.8.

The State has had limited success in enforcing the law. Even when local governments comply with the housing element law, it does not guarantee that homes will get built. Local land use decisions often override the goals of the State. Some local governments simply do not want to fulfill their "Fair Share" of housing goals.

Sometimes, even the best housing element plans are overrun by local citizens, who either use the ballot box to control growth or file lawsuits to delay or derail low-income housing developments.

Finally, in the aftermath of Proposition 13, local governments that comply with housing element law and embrace low-income housing development frequently do not have the budget resources to adequately provide police, fire protection and other services to those neighborhoods, or have difficulty attracting developers because of the accompanying financial risks.

Capital Constraints

To produce enough housing to meet projected demand, developers, investors and homeowners must have access to capital, either equity or debt capital. Capital can be either private or public.

In recent years, both private and public capital have been plentiful for developing and financing single family homes. Private capital for multifamily projects, other than very high-end projects, has been less available. Public subsidies, a necessity for the production of low- and very low-income multifamily projects, have declined during the past two decades.

The federal Tax Reform Act of 1986 eliminated the 15-year depreciation schedule for low-income rental housing, severely compromising the tax advantages for investors. As a result, private investment in multifamily housing dropped off dramatically. Although the federal government responded to the decline with the Low Income Housing Tax Credit program in 1986, production of multifamily units remains far below pre-1986 levels.

Investment equity for the development and purchase of rental housing has been limited in recent years to the upper-end market, where higher rents continue to make apartment development profitable. Rents in many California apartment markets, even though high from the perspective of middle- and low-income families, are below the level necessary to attract investment capital.

Land Costs

California's land and construction costs are typically higher than any other area in the United States. Land scarcity is a more significant issue for the most populated counties, including Los Angeles, Orange and Santa Clara. Availability fuels prices and as a result, land costs vary by region – from a high of $40 per square foot in Santa Clara County to a low of $10 per square foot in Fresno County.

While geography is a natural constraint, in many metropolitan areas land availability is also limited by local government planning decisions. A recent study revealed that except in a few critical locations, California has ample room to grow. California's 35 metropolitan counties contain 25 million acres of potentially developable raw land. Exclude from that inventory sites that are far away from urban areas, steep slopes, wetlands, floodplains, prime and unique farmlands and habitats for endangered species, and 8 million acres remain – enough to accommodate projected household growth through the year 2020 more than three times over.[28] If the land is available, why is it not being developed for desperately needed housing?

Construction Costs

Construction costs vary throughout the State, with "hard costs" ranging from $95 per square foot in Santa Clara and Los Angeles counties to a low of $60 per square foot in Fresno County.[29] Other factors influencing construction costs are local development fees that vary from a low of $4,000 to a high of $60,000 per unit.[30] Often, the cost per square foot for high-density infill housing is much higher due to building and infrastructure challenges.

Construction prices also will be effected by the recent passage of SB 975, the Prevailing Wage Law. The law requires all projects that receive public subsidies to pay prevailing wages. While union officials maintain the effect on prices will be minimal, affordable housing advocates assert the law could drive up construction costs by as much as 30 percent, potentially outweighing the benefit of government subsidies.

Regulatory Issues

California's development approval process is the most complicated in the nation. Developers often must pass through a variety of local zoning hurdles as well as State regulatory requirements. Because the procedures are time-consuming and complicated, they inevitably add to the final cost of housing.

Local limits – including public facility requirements, growth management rules and urban growth boundaries – further complicate the approval process for housing developers. Often, state regulations intended to protect natural resources and the quality of life in California are employed by neighborhoods opposed to the development of low- and very low-income housing. In what is commonly known as "NIMBY"ism (Not In My Back Yard), neighborhood groups use various regulations to limit local growth, increasing costs to developers and ultimately to renters and homeowners.

Anti-NIMBY Law

The passage of what is known as the California Anti-NIMBY Law has given developers a new tool in the approval process. The law prevents local agencies from disapproving a low-income housing project or imposing conditions that make the project unfeasible unless it meets one of six narrow conditions, based on substantial evidence. The law strengthens the affordable housing developer's ability to sidestep additional, unnecessary legal hurdles.

Source: Government Code Sec. 65589.5.

A recent study reviewed 46 projects to determine the affect of the approval process on housing. The study concluded that jurisdictions interested in accommodating new housing were able to review proposed projects in a timely manner. Conversely, communities interested in deterring housing developments were able to use the regulatory process to achieve that goal.[31]

Consequences of Not Solving the Problem

Severe social and economic consequences will result if California fails to address the affordable housing problem. Fewer people will achieve homeownership. Children born and raised in California will not be able to afford to live in the communities where they grew up. Low-income workers will spend more and more of their limited income on rent. Others will be homeless.

> **_Silicon Valley: Housing Crisis_**
>
> The Silicon Valley provides a startling example of the labor difficulties arising from the lack of affordable housing. Rapid job growth placed a strain on the labor force in the region. The influx of new employees, in turn, placed a strain on the region's housing. Job growth outstripped housing growth by a factor of four.
>
> Housing affordability declined to 16 percent in 2000, compared to 60 percent nationally. The lack of affordable housing made it difficult to attract and retain workers. The inability to hire qualified people cost Silicon Valley companies an estimated $3 billion in recruitment and hiring fees.
>
> Source: Joint Venture: Silicon Valley Network, *Next Silicon Valley: Riding the Waves of Innovation*, December 2001.

One of the biggest impacts of the lack of affordable housing has been on commute times. In most American cities, housing prices are typically highest near job centers where land is expensive and home building is difficult. Prices are lowest at the urban fringe, where land is less expensive and growth is more politically acceptable. Typically, low-income workers are less able to afford homes near their jobs, creating a jobs-housing imbalance. These workers move farther and farther away from job centers adding to traffic congestion and pollution. Additionally, the quality of life for these workers diminishes as family time and community time is constrained.

The lack of affordable housing for workers undermines the strength of the California economy. In the long run, it is unlikely that California can sustain its economic growth if housing costs continue to rise as they have for the past 25 years. Housing has become an increasingly important factor affecting economic development. Company executives strongly consider the cost of housing when looking for business locations. Not only is housing key to the quality of life, but high housing costs pressure businesses to pay higher wages.[32]

Overcrowding is another result of the lack of affordable housing. In 1997, 13 percent of renter households in the state's metropolitan areas lived in overcrowded conditions. Not surprisingly, families with children are the most likely to live in overcrowded conditions. In 1995, 40 percent of California children lived in renter households that were overcrowded.[33]

Responses to the Problem

For more than 60 years the federal government has attempted to address the housing needs of the poor through various subsidy programs. State and local government programs were implemented in the 1970s as federal support began to decline.

California in the mid- to late-1980s was a national leader in programs and funding for affordable housing. However, during most of the 1990s, state funds for housing decreased. The past few years saw a resurgence in state funding, only to diminish again as a result of the current budget constraints.

The response from local governments has primarily come through redevelopment agencies and the administration of federally funded local programs. Local housing trust funds are another phenomenon on the rise in the attempt to address housing needs.

Federal Government Programs

The largest portion of public funding comes from the federal government in the form of direct subsidies, tax credits, grants and loans. Federal involvement in housing dates back to the Housing Act of 1937, which established local public housing authorities that used federal money to demolish substandard housing and build new housing for the very poor. In 1965, the federal government established the Department of Housing and Urban Development (HUD) which oversees the majority of current federal programs.

HUD programs have shifted away from constructing low-income housing toward providing very low-income renters with vouchers they can use on qualified units through the Housing Certificate Fund. Still, there are more than 25,000 publicly owned housing units.

Recently, the federal government has allowed housing certificates to be used for down payments on home purchases. All of these programs, except in a few rural locations, are managed by local public housing authorities.

New Federal Initiatives

Two bills under consideration by the U.S. Congress to address the affordable housing crisis nationally are H.R. 2349, the National Affordable Housing Trust Fund Act of 2001 and H.R. 3995, the Housing Affordability for America Act of 2002.

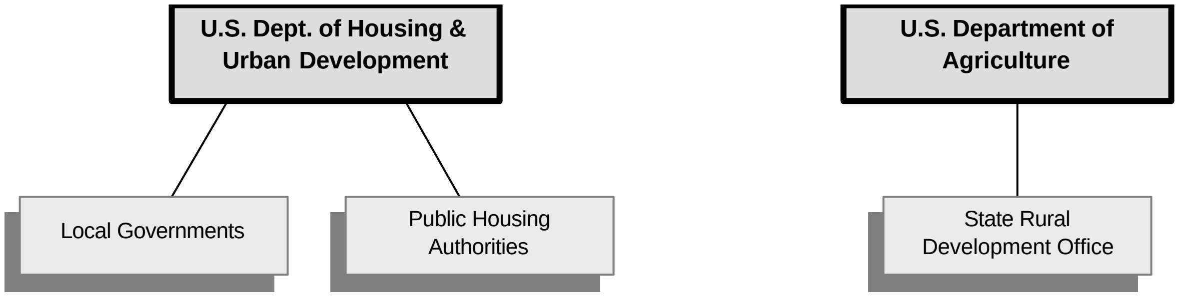
As proposed, H.R. 2349 would create a national housing trust fund. In 2002, excess revenue generated by the Mutual Mortgage Insurance Fund and the Government National Mortgage Association would be used to establish the trust fund. The national housing trust fund will award grants to state governments based on various affordable housing need factors.

H.R. 3995 would create a new affordable housing production and preservation element within the existing HOME Investment Partnership (HOME) Program targeting very low- and extremely low-income families and refines various Housing and Urban Development (HUD) programs.

Sources: H.R. 2349 National Affordable Housing Trust Fund Act of 2001. Michael G. Oxley, chairman, U.S. House of Representatives, Committee on Financial Services and Javier Gonzalez, commissioner of Santa Fe County, New Mexico and president, National Association of Counties. Testimony to U.S. House of Representatives Subcommittee on Housing and Community Opportunity. April 10, 2002.

Federal Affordable Housing Program Expenditures 2000-2001

(Dollars are in millions)



Local Governments — *$688.5*

$492	Community Development Block Grants
$184	Home Investment Partnerships
$12.5	Emergency Shelter Grants

Public Housing Authorities — *$2,405.2*

(FY 2000)

$100.6	Low rent housing assistance
$2,100.8	Housing Certificate (Section 8 Vouchers)
$1.4	HOPE Program
$202.4	Homeownership Programs

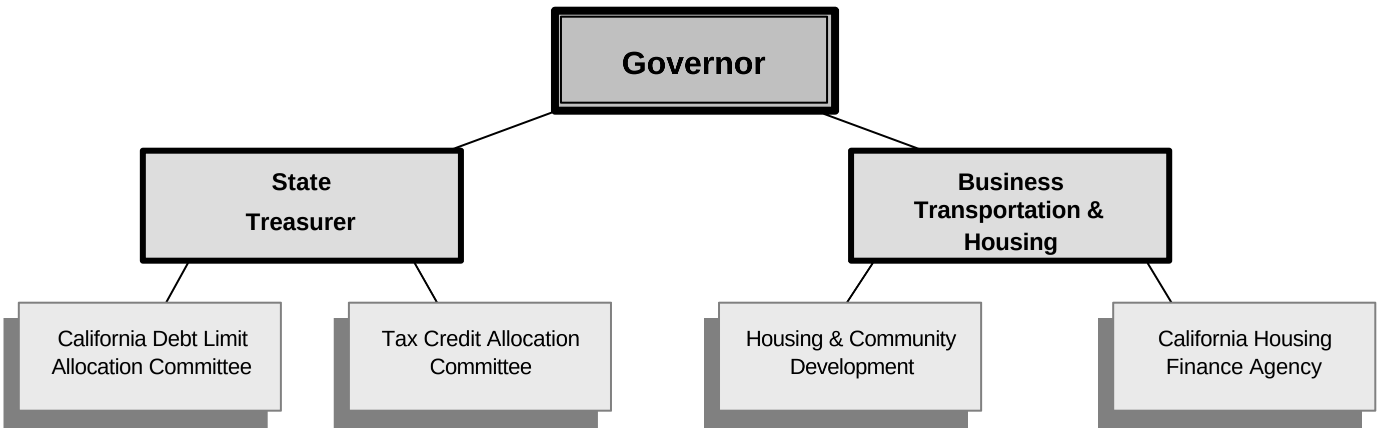
State Rural Development Office — *$118.2*

$97.6	Rural Housing
	Single Family 502
	Guaranteed Loans
	Sect. 504 Repair
	Elderly
	Technical Assistance
	Site Loans
$20.6	Multifamily Housing

Sources for affordable housing expenditures charts:
HUD Allocation Data, HUD, 2001 CDP Formula Allocations; US Census Bureau, *Federal Aid to States for Fiscal Year 2000*; USDA Rural Housing Service, California State Office, FY2001 *Summary of Funds Obligated by County*; Laurie Weir, Executive Director, California Debt Limit Allocation Committee, Personal communication, April 16, 2002; Jeanne Peterson, Executive Director, California Tax Credit Allocation Committee, Personal communications, April 29, 2002; Housing & Community Development, *Consolidated Annual Performance and Evaluation Report: FY 2000-01*; Michael Cohen, Senior Fiscal & Policy Analyst, Legislative Analysts Office, Personal communication, February 4, 2002; California Housing Finance Agency, *News Release #2001120*, December 2001; State Controller's Office, *Community Development Agencies Annual Report 1999-00*.

State Affordable Housing Program Expenditures 2000-2001

(Dollars are in millions. State funds are in bold; federal funds are in italic.)



California Debt Limit Allocation Committee — **$1,760.0**

$1,760	Tax exempt private activity bonds

Tax Credit Allocation Committee — *$110*/**$35.9**

$52	Federal 9 % Low Income Housing Tax Credit
$58	Federal 4% Low Income Housing Tax Credit
$35.9	State Low Income Housing Tax Credit

(2000 calendar year)

Housing & Community Development — *$103.7* / **$280.8**

Federal Programs Administered by HCD

$44.2	Community Development Block Grants
$48.2	Home Investment Partnerships
$5.7	Emergency Shelter Grant Program
$2.4	Housing of Persons with AIDs
$3.2	Housing Assistance Program (for rural areas with no public housing authority)

State Programs

$116.8	Multifamily Housing
$5.9	Jobs Housing Balance
$42.9	CalHome
$10.6	Downtown Rebound
$37.2	Emergency Housing Assistance
$3.2	Interregional Partnership State Pilot
$5	Code Enforcement
$33.6	Farmworker Housing
$13.7	Office of Migrant Services
$2.5	Housing Preservation
$2.1	Self-Help Housing
$5	Mobile Home Park Residential Ownership
$2.3	Predevelopment Loan Fund

California Housing Finance Agency — **$1,780.5**

$1,000	Single Family Loans
$165.5	Multifamily Loans
$615	Mortgage Loan Insurance

Local Affordable Housing Program Expenditures 1999-2000

$343.2

Redevelopment Agency 20 percent set-aside expenditures

In 2000, HUD spent more than $2.4 billion on the various programs managed by California's local housing authorities.

HUD also funds a variety of subsidy programs for state and local governments. The largest are the Community Development Block Grant program and the Home Investment Partnership Program. In 2000-01, funds for these programs totaled more than $792 million in California.

One of the most popular federal low-income housing subsidies, the Low Income Housing Tax Credit program, was authorized by Congress in 1986 to replace traditional housing tax incentives, such as accelerated depreciation, with a tax credit that enables developers of affordable rental housing to raise equity through the sale of tax benefits to investors.

There are two types of federal tax credits, a 9 percent competitive tax credit and a 4 percent non-competitive tax credit that is typically awarded in conjunction with tax-exempt bond financing. Both programs are administered by the California Tax Credit Allocation Committee.

Annual allocations of the 9 percent federal tax credit program are capped at $1.75 per state resident as of January 2002 and will be adjusted for inflation each year. This amount was increased from $1.25 in 2000 and $1.50 in 2001. In 2000 in California, $52 million in 9 percent federal tax credits and $58 million in 4 percent federal tax credits were issued.[34]

Additionally, the U.S. Department of Agriculture and its State Rural Development Office offers rural single family and multifamily housing grants and loans, which in 2000-01 totaled over $118 million in California.

State Government Programs

California's support of affordable housing programs has fluctuated sharply during the past two decades. During the late 1980s, California implemented a series of innovative housing programs and provided substantial funding for affordable housing. In 1987, the State created a supplement to the federal low-income housing tax credit and passed three affordable housing bond measures in 1988 and 1990.

During the early 1990s, these bond proceeds supported a substantial investment in affordable housing. However, as these funds dried up, minimal state funds were allocated to take their place. Most recently in 2000 and 2001, new and existing programs received substantial increases in funding. However, with the projected budget shortfall beginning in 2001-02, housing funds were scaled back again.

Most state housing programs are administered by three separate entities. The Department of Housing and Community Development and the California Housing Finance Agency are both within the Business Transportation and Housing Agency. The State Treasurer's Office oversees the Tax Credit Allocation Committee and the California Debt Limit Allocation Committee.

Department of Housing and Community Development (HCD). The department of Housing and Community Development administers a variety of state and federal programs. HCD's budget for major housing programs in 2000-01 was originally $538 million. Due to the State budget shortfall, actual expenditures for the year were $280.8 million.

HCD provides grants and loans through such major programs as the Multifamily Housing Program, Jobs-Housing Balance Improvement Program, Downtown Rebound, homeownership assistance for low and very low-income earners and farmworkers, homeless shelter grants and other specialized programs.

California Housing Finance Agency (CHFA). The mission of the California Housing Finance Agency is to provide below-market rate loans for rental housing development and first-time homebuyer assistance. CHFA originated $1.1 billion in single and multifamily family home loans and $615 million in mortgage loan insurance in 2000-01.

Tax Credit Allocation Committee. In calendar year 2000, $35.9 million in state low-income housing tax credits were provided through the California Tax Credit Allocation Committee (TCAC).[35] The California tax credit mirrors the federal tax credit in that credits are sold to help low-income housing developers raise equity for projects. California's tax credits are only available to developers who qualify for the federal tax credit program and must be used for rental housing development. These credits are awarded on a competitive basis and in most recent years the ratio of applications to awards has been 4 to 1.

The Legislature voted to raise the amount of tax credits available beginning in 2002 to $70 million per year. Like the federal program, credits will be adjusted annually for inflation.

California Debt Limit Allocation Committee (CDLAC). The California Debt Limit Allocation Committee (CDLAC) administers the tax-exempt private activity bond program. Bonds are purchased by the private sector and the repayment is not an obligation of the State. In 2001, $1.76 billion in housing-related bonds were issued. Of that amount,

$1.09 billion was for multifamily housing revenue bonds and $669 million was for single family housing revenue bonds.[36]

Local Government Programs

The vast majority of local funding for affordable housing comes from redevelopment agencies. Begun in California in 1946, the mission of redevelopment agencies is to cure "blighted" property and develop and rehabilitate housing. There are currently 378 active redevelopment agencies. The agencies are funded through incremental property tax revenue increases and are required to set aside 20 percent of this revenue for low- and moderate-income housing.

Santa Clara County Trust Fund

The Housing Trust Fund of Santa Clara County is a venture that combines public funding, corporate donations and funding from non-profit foundations. In July 2001 the fund had raised $20.2 million. Less than 120 days later, the trust fund had generated 45 loans for first-time homebuyers and dedicated $1.78 million in gap financing for five affordable housing projects.

Source: Housing Trust Fund of Santa Clara. http://www.housingtrustfund.org.

Redevelopment agencies vary in their ability to develop affordable housing. Success often hinges on market fluctuations and local government leadership. Most redevelopment agencies work indirectly with the housing industry by providing "gap" grants and financing to housing developers. In 2000-01, redevelopment agencies spent $343 million for low- and moderate-income housing.

Housing trust funds are another emerging source of local subsidy. There are currently 13 housing trust funds in the state. Los Angeles recently approved a $100 million housing trust fund. Money for the fund will come from several sources, including community development block grants, redevelopment agency funds, tobacco settlement funds and an increase in vehicle license fees.

Emerging Trends & Opportunities

Brownfield Remediation. An important opportunity to make more land available for housing in certain metropolitan areas and to achieve "smart growth" goals lies in urban "brownfields" – abandoned industrial and commercial properties. California public policy makes it difficult for developers to seize this opportunity, particularly when it comes to housing. To date, uncertain environmental standards and unlimited liability have rendered many of these properties useless. Recent legislation holds promise to increase development of these underutilized land parcels.

Efforts to Attract Private Investment. The vast majority of private capital invested in affordable housing developments comes from the banking industry. Other sources of potential private capital include insurance companies, pension funds, brokerage firms and foundations.

Transportation Policies that Promote Housing. Recent developments in affordable housing production have creatively partnered transportation policies with "transit friendly" affordable housing developments. The Metropolitan Transportation Commission (MTC) in the nine Bay Area counties has recently completed a pilot program based on a San Mateo County model using federal transportation money to mitigate transportation impact fees.

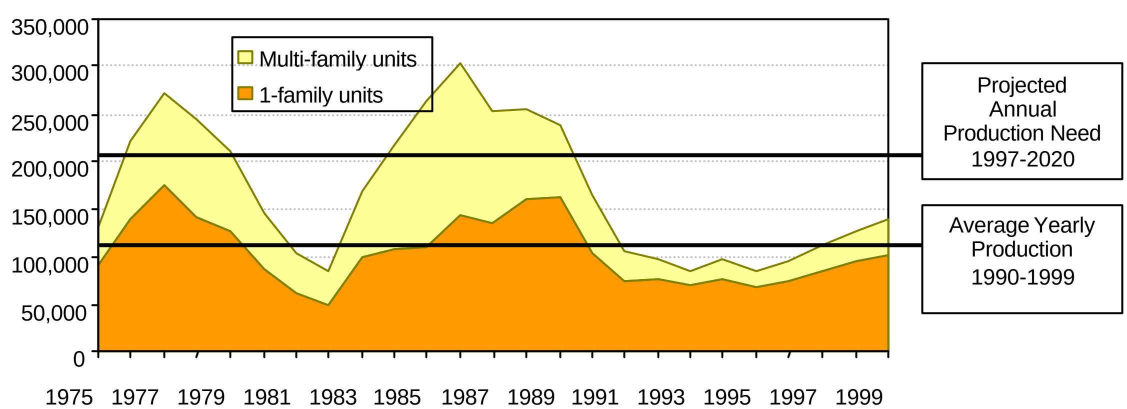
Land for Homes: From Planning to Performance

Finding 1: California does not have adequate state policies to ensure that local communities provide housing at all income levels, particularly for those at the lowest income levels.

California's deep-rooted tradition of "home rule" frequently collides with the State's interest in providing adequate housing for its growing population. For the marketplace to effectively respond to the need for housing at all income levels, local governments must zone adequate amounts of residential land and reduce or eliminate barriers to the development of housing. The tension between the statewide interest and the desire of local communities to control their own destinies is often exacerbated when it comes to affordable housing.

Research conducted for the State's housing agency by the University of California shows that California, except in a few major metropolitan counties, has plenty of land that is appropriate to accommodate projected population growth through the year 2020 – more than three times over.[37] Nevertheless, California is falling further behind in housing production. Communities fail to produce housing for a number of fiscal and political reasons. By limiting property taxes, Proposition 13 reduced a key incentive for local governments to approve housing, particularly affordable housing. Rather, jurisdictions have a fiscal incentive to approve high-end housing, which generates enough revenue to pay for the required services, or retail developments, which generate sales tax

Annual Housing Production Needs: 220,000 Units



Source: John Landis, testimony to Little Hoover Commission, April 26, 2001.

revenue. Neighbors often oppose affordable housing projects because they are smaller units built to higher densities, making those projects a political liability as well.

The Housing Element Law

In 1965, the State enacted the housing element law to compel cities and counties to at least plan for a growing population, and in particular to increase homes near job sites. The housing element law requires communities to identify current and projected needs for housing, an inventory of land and infrastructure that could accommodate its share of the regional housing need by income level, and any constraints to housing development. In 1977, the concept of fair share was implemented, setting the stage for much of today's debate over how housing quotas are determined and allocated. Despite implementing the fair share concept, the housing deficit has gotten progressively worse.

Housing Need Allocation Process

The Department of Housing and Community Development (HCD) allocates the projected need for housing by region for the relevant planning period based on demographic factors, primarily household growth projections, from the Department of Finance (DOF). DOF allocates a statewide share of projected population growth by county and prepares household growth projections based on these county shares.

HCD adjusts the projected household growth by adding allowances for vacancy and/or replacement housing. Prior to allocating the projected regional need, HCD consults and works with the regional Councils of Governments (COGs) to determine regional "fair share" numbers that are consistent with transportation planning demographic data. HCD then allocates the projected need for regional housing to the COG, except in a few rural locations where the State works directly with local jurisdictions.

COGs then develop a Regional Housing Need Assesment allocating the region's share of the statewide need to local jurisdictions based on considerations such as market demand, commute and employment patterns, land availability, infrastructure and other regional trends. COGs have the discretion to redistribute the projected household growth within constituent counties, as long as the total allocation for housing need is met within the region.

Sources: Methodology for Projection of Regional Housing Need, Housing & Community Development (HCD) and Cathy Creswell, deputy director, HCD, at Advisory Committee Meeting, October 3, 2001.

Housing Element Controversies

The housing element law has become increasingly controversial in recent years among legislators, state and local officials and housing advocates. According to the Department of Housing and Community Development, 64 percent of jurisdictions have complied with the law, meaning that they have plans approved by the department. These 64 percent have produced 78 percent of single-family and 91 percent of multi-family units, evidence according to supporters that the housing element law does result in more housing.

Many jurisdictions dubbed out of compliance with the law have submitted plans that they assert meet state requirements, but that the department has not approved. Some of those jurisdictions also show high housing production. Short of lengthy and costly third party lawsuits, there is no mechanism for resolving disputes over housing elements.

A fundamental controversy surrounds how housing quotas are determined. Local and regional governments assert that growth projections developed locally to meet transportation and air quality mandates should be used to determine regional "fair share" allocations, rather than the Department of Finance projections used by HCD. Local jurisdictions also say that when Councils of Governments (COGs) allocate numbers locally, the process becomes politicized, resulting in less influential jurisdictions receiving unjustly large numbers.

In some communities, neighborhood opposition, or "NIMBYism," has effectively derailed efforts to build affordable housing. But when local governments zone land correctly and encourage public participation in the development of general plans and housing elements, fewer subsequent government reviews are required and there are fewer opportunities for neighborhood opposition. The California Anti-Nimby Law prevents local governments from disapproving a low-income housing project or imposing conditions that make the project unfeasible unless it meets one of six narrow conditions. The law strengthens the ability of developers to sidestep additional, unnecessary legal challenges.

Housing Element Law Shortcomings

Two fundamental problems hinder the effectiveness of the housing element law as a tool for advancing the State's affordable housing goals.

1. The law has no "teeth." In the housing element law the State has created a top-down process to shape land-use decisions by hundreds of local governments. The law requires cities and counties to plan for housing, but contains no enforcement mechanism. There are few, if any, consequences for failure to plan. In theory, jurisdictions could be ineligible for some state housing funds if their housing element is not certified by HCD. In reality, this consequence has little impact because the jurisdictions that are out of compliance also are often not interested in building affordable housing. To be effective, the jeopardized funds would need to be those that communities want, like those for transportation, parks or schools.

Additionally, the State has inconsistently implemented the requirement for local housing element planning. In 1992-93, the Legislature suspended the funding of certain housing element mandates, including the Regional Housing Needs Assessment. With no data to base plans on, local governments simply did not update their housing elements. Funding was re-instated in the late 1990s and by the end of 1999, local governments were once again required to update their housing elements.

2. The law focuses on planning, not performance. The focus of the housing element law is on planning, so that even when jurisdictions have plans approved by the State, there is no mechanism to ensure that the planned housing actually gets built. Local governments cannot control production, but they can encourage it through zoning for housing, reducing regulatory requirements pertaining to parking and lot size and giving the general plan primacy over the permitting process. In many jurisdictions, general plans are quickly amended to accommodate specific projects and neighborhood complaints, undermining, on a project-by-project basis, the long-term housing goals.

Furthermore, the State does not have a mechanism to track actual construction of new housing and compare that to local and regional quotas. Many local jurisdictions do not maintain data on residential building permits and even fewer track occupancy certificates, a more precise measure of performance.

The law requires jurisdictions to submit annual progress reports to HCD on their general plans, including the housing element. But most jurisdictions do not complete the reports, citing a lack of resources.

Recent Efforts

In response to the growing shortage of housing, some policy-makers advocate stiff penalties for jurisdictions that fail to comply with the housing element law. But so far, local government officials have fended off the idea of penalties. Similarly, policy-makers have had trouble tying incentives or penalties to the housing element or housing production, with local governments asserting that incentives and penalties diminish their local control or limit access to funds they are entitled to receive.

SB 910, authored by Senator Joseph Dunn, proposed penalties for local governments that fail to comply with the housing element law. Penalties would include withholding a percentage of highway maintenance and repair funds from local governments who do not adopt a housing element and fines when a housing element is found by a court to be invalid.

A working group has been convened to resolve opposition and look for a compromise solution. The working group and subcommittees of the group met for several months to develop language to do the following:

- ✓ Reform the housing needs allocation process.
- ✓ Increase the opportunity for public participation in the housing element planning process.
- ✓ Enhance implementation of the housing element plan.

- ✓ Allow HCD to audit compliance throughout the planning period for certain clearly specified portions of a housing element.

Strengthening the State's Role

The housing element law has failed to ensure that the State's goals for housing – particularly affordable housing – are met. Currently about 2.4 million, or 22 percent, of California households need some form of housing assistance. If the percentage stays constant, the number of households needing housing assistance could rise to 3.7 million by 2020.[38]

The State can no longer simply encourage and hope that more than 500 local jurisdictions collectively do what is in the best interest of California and some of its most vulnerable citizens. It must assume a far more assertive stance than it has in the past to ensure that California residents – now and in the future – have safe, decent and affordable housing.

The goals of reform should be to strengthen the planning process, encourage better land use decisions, address community concerns and safeguard "local control." The Commission identified five opportunities to focus the housing element law on performance.

1. Fortify the housing element process. The requirements of the law should be clear, measurable and enforceable. The development of a model housing element would help cities and counties comply with the law. It could include a template for the needs assessment, suggestions for evaluating the previous housing element, examples of how to prepare an adequate site identification and a list of potential programs that local governments could include in the housing element to meet the requirements of the law.[39]

Annual progress reports should be required of local governments and responded to in a timely manner by HCD.

Housing plans should identify opportunities for brownfield redevelopment and other in-fill and mixed-use housing development. Constraints to the development of those types of sites should be addressed in the housing element and annual progress reports.

The housing allocation process should better reflect local and regional issues and trends. It should allow growth projections used by COGs for transportation and air quality plans to be used as the basis for housing growth projections and incorporate job projections. Greater public participation in the development of housing elements would avoid community opposition that can erode housing goals on a project-by-project basis.

Considerable weight should be given to the recommendations of established working groups when reforming the housing element law and the housing needs allocation process.

To better understand development and to assess local decision making, production should be measured. Some jurisdictions do track building permits, but they are not required to provide the data to COGs or the State. With some State resources and assistance from the COGs, cities and counties could be required to track building permits or occupancy certificates. Local jurisdictions could report the information to the COGs who in turn could report it to a state database.

2. Link fiscal incentives to housing production. The State distributes a variety of funds that help communities to grow, from Community Development Block Grants, to transportation money, to bond programs to pay for parks and open space. The State should link eligibility for these funds with housing element compliance and housing production. Cities and counties have resisted new conditions for existing funds, asserting it was unfair to deny funds they previously received. But at the least, future funds could require compliance.

Sales Tax Sharing Proposal

A pilot sales tax sharing program proposed by Assemblyman Darrell Steinberg (AB 680) would dramatically alter sales tax distribution in the Sacramento region to encourage affordable housing development and discourage competition for retail development. Currently one percent of all sales tax dollars are returned to the city where the tax is incurred, making all sales tax-generating businesses highly coveted. To encourage more affordable housing development the bill proposes to split the one percent into three parts and distribute it as follows:

- One part would go to the region on a per capita basis.
- One part would be directed toward cities in the region that created open spaces and affordable housing.
- One part would stay in the city or county where the tax was collected.

Source: AB 680. December 2001.

The State should focus on fiscal incentives that would encourage communities to approve and build multifamily housing, in-fill housing and housing close to transit centers and jobs. For example:

✓ Housing element compliance and housing performance could be considered in awarding state or federal grants and loans.

✓ Housing performance could be linked with funding for transportation, parks, schools or other projects.

✓ Housing performance could be linked with the discretion that redevelopment agencies have in spending tax increment funding.

✓ Housing performance could be linked to how much discretion local communities have in spending Community Development Block Grants.

✓ Additional tax increment funds could be provided to communities that meet or exceed their affordable housing goals.

- ✓ The State could encourage regions to redistribute sales tax revenue to neutralize the financial bias toward retail development.

COGs and local jurisdictions could work cooperatively to pursue those fiscal incentives that best meet their needs.

3. Align Conflicting Policies. Local government officials assert that state planning and regulatory policies hinder their ability to reconcile their housing elements with other aspects of the general plan and meet their obligations for housing.

- ***Planning policies.*** As described earlier, local officials advocate using population growth projections developed regionally for transportation and air quality planning to determine housing needs allocations. They assert those projections are more accurate and would provide consistency and integration in the planning process. HCD has opposed the use of projections generated by COGs and local governments claiming there is too much potential to inflict political bias into the process.

  The law requires local jurisdictions to prepare housing elements every five years and transportation and air quality plans every three years. If housing elements were required every six years, they could coincide with transportation and air quality planning cycles.

- ***Regulatory policies.*** Critics also point to conflicts in state regulatory policies. The Commission heard that the project review process required by CEQA can be used to stymie growth on a project-by-project basis. Attempted solutions include integrating CEQA into long-range planning, rather than waiting until projects are proposed, and adopting master environmental impact reports.[40]

  Other policies described as problematic are the Williamson Act, which preserves agricultural land, the open space element of general plans and recent legislation requiring that adequate water supplies be identified prior to approval of subdivisions

Rewarding Transit-Oriented Housing

San Mateo County pioneered an innovative link between housing and transportation funding. In 1999, the San Mateo City/County Association of Governments set aside $2.2 million in State Transportation Improvement Program funds for its Transit Oriented Development Incentive Program.

The program rewards local governments that locate new housing within one-third of a mile of Bay Area Rapid Transit (BART) and Caltrain stations. Communities can earn up to $2,000 per bedroom for housing constructed near transit stations and building at least 40 units per acre. Five projects involving 1,300 bedrooms are under development.

The funding does not directly subsidize the projects, but can be used for transportation-related improvements.

The program was recently replicated by the Bay Area's nine-county Metropolitan Planning Commission with its Housing Incentive Program. In 2001, MTC set aside $9 million in primarily federal funding to encourage transit-oriented development. MTC plans to expand the program to $27 million in 2002.

Source: Brian Smith, deputy director, Planning and Modal Programs, Department of Transportation. Testimony to Little Hoover Commission, January 24, 2002.

with more than 500 units.[41] These issues and conflicts are very real, particularly as communities seek to grow beyond urban boundaries. They present fewer problems when communities pursue affordable, in-fill housing opportunities in urban areas with existing infrastructure – practices known as “smart growth.” Some analysts estimate that California could address 35 to 50 percent of its housing needs if it broadly and effectively implemented “smart growth” strategies. So, while an important part of the solution, it is only part of the solution.

The State has established important, but difficult to reconcile goals for housing, transportation and environmental policies. There are examples of the State working with locals to reconcile and coordinate these policies. In Riverside County, state transportation and resources officials are working with local officials to reconcile transportation planning and habitat conservation planning with the development of local general plans. But more can be done. The goal should be to streamline and rationalize the planning process for local governments, to diminish conflicts and barriers for communities seeking to provide needed housing, and to do so in ways that does not weaken appropriate environmental protections and standards.

4. Provide guidelines and technical assistance. To increase the supply of affordable housing, communities need to zone more land for housing, increase general plan and zoning densities to allow for higher density residential development and rethink other standards.

For example, parking requirements can have a significant effect on affordability. The cost of developing structured parking is between $20,000 and $35,000 per space.[42] The Transportation Center at the University of California at Berkeley has conducted studies that show parking requirements for most “shared wall” units are excessive. Surveys revealed high numbers of vacant parking spaces. Researchers concluded that one space per unit is more than adequate and that one-half space per unit is reasonable.[43]

Similarly, planning and zoning policies often discourage a mixing of housing types and sizes – reducing opportunities for low-end housing.

Maryland and Massachusetts established university-based resource centers to help local governments fashion and adopt “Smart Growth” zoning controls. California could follow their lead by partnering with the University of California to develop model zoning ordinances and best practices guidelines. It should make these widely available to communities and provide technical assistance to help communities implement innovative strategies to reduce the cost and enhance their ability to build affordable housing.

Recommendation 1: To make sure its housing goals are met, the State should implement a comprehensive set of planning policies and fiscal incentives to ensure that local jurisdictions effectively plan for and actually produce affordable housing. Specifically, the State should:

- ***Strengthen and enforce the housing element law.*** The Department of Housing and Community Development should clarify what is required of local jurisdictions, ensuring that the requirements of the housing element law are measurable, and standardizing the review and approval process. It should prepare a model housing element to assist local governments to comply with the law.

- ***Reform the housing needs allocation process.*** The State should reform allocation of housing requirements based on the recommendations of established working groups and implement a process to resolve disputes over allocation decisions. Once reforms are implemented, the State should sanction communities that remain out of compliance.

Empowering Councils of Governments

The State should explore opportunities to enlist Councils of Governments (COGs) as partners in accomplishing statewide and regional goals for housing. It should consider a system in which regional housing goals influence housing funding decisions – similar to the transportation planning and funding process.

Transportation policy and funding decisions evolve around a regional planning process where priorities and goals are established at the local and regional levels and are aligned with funding decisions.

COGs perform the state-mandated Regional Housing Needs Assessment – essentially a housing market and needs analysis. But there is little connection between that process and the allocation of funds to support the identified needs for affordable housing.

If COGs were given the authority to influence performance, outcomes could be improved. Specifically, the State should consider expanding the role of COGs to include:

- ✓ Working with cities to assure the State that there are adequate sites to meet regional needs.
- ✓ Allocating some housing funds based on regional needs and goals.
- ✓ Working with cities to transfer quotas when more affordable housing can be produced closer to jobs.
- ✓ Rewarding cities that accept higher allocation numbers.

Such a system would align planning and funding processes for affordable housing and integrate transportation, housing and other regional planning issues.

Roles for the State under such a system that have been suggested include review and approval of regional plans and participation with the COGs in funding decisions.

Sources: State Affordable Housing Resources: The Case for a Regionally-Based Allocation System, discussion draft, revised August 14, 2001, Southern California Association of Governments, Department of Planning and Policy, Community Development Section. Personal Communications: Mark Pisano, Rusty Selix, DeAnn Baker.

- ***Align conflicting policies.*** The State should reconcile state policies that conflict with its goals for affordable housing, including policies for environmental protection, agricultural and open space preservation, and water supplies. It should align time frames and planning processes for transportation, air quality and housing and establish a venue to resolve conflicts. The development of housing, especially affordable housing, should be given greater emphasis.

- ***Provide fiscal incentives.*** The State should link future funding sources – such as transportation funds and proceeds from park or other bond measures – to a community's progress toward meeting its housing goals. It should identify funding sources that communities want and that would be effective incentives to produce housing. The State should pursue agreements with COGs and local governments in their regions on a set of incentives and penalties that are best aligned with local circumstances.

- ***Track performance.*** The State should develop a statewide database to track construction of new housing and compare it to housing element plans. COGs should assist cities and counties to track building permits and occupancy certificates and report the data to the State.

- ***Provide guidelines and technical assistance.*** The State should provide guidelines and technical assistance to help communities resolve conflicts and plan for and implement innovative strategies for affordable housing. It should utilize the expertise of the University of California to establish model zoning ordinances and best practices, including, for example, in-law housing and parking requirements for multifamily housing.

Land for Homes: Restoring Brownfields

Finding 2: Urban brownfields are an undeveloped opportunity to make land available for affordable housing close to job centers, break the cycle of deterioration and enhance the well-being of surrounding neighborhoods.

A major opportunity to respond to the scarcity of land in certain metropolitan areas and to conform to "smart growth" strategies lies in the urban brownfields that mar the landscape of cities statewide. In states like New Jersey and Pennsylvania, dilapidated buildings and tainted soils surrounded by cyclone fences are being transformed. In their places stand new retail and high-tech businesses, attractive and affordable housing and recreational opportunities.

Like other states, the majority of California brownfields are located in low-income and minority communities. They are accompanied by urban decay, health hazards and lost economic opportunities. Current policies make it difficult for developers to restore these parcels to productive uses, particularly for housing. Uncertain environmental standards and unlimited liability have scared off developers and lenders and rendered many of these properties useless.

The executive director of the California Center for Land Recycling testified that "everyone of the estimated 90,000 brownfields in California is a missed opportunity for an affordable housing development, a public park or a commercial complex that most likely will be built elsewhere. Consequently, unrestored brownfields serve only to fuel development on our remaining landscapes." [44]

Contaminated properties and efforts to revitalize them have been the subject of concern and controversy for years. In 1980, Congress and the President signed what is commonly known as the "Superfund Act." The Act made polluters liable for the costs of toxic cleanup that occurred before they purchased the site. Taxes on oil and chemical products were levied to create a "Superfund" to pay for cleanup of "orphan sites" – those where no responsible party could be found. The law was designed to cover only the most hazardous and costly sites nationwide, but revenues collected fell far short of the amounts necessary to clean up all "orphan sites." An unanticipated consequence of the law was the chilling effect it had on redevelopment of land that involved even the perception of contamination.

In the 1990s many states, including California, began brownfield remediation programs separate from the Superfund initiative.[45] But a number of problems have frustrated California's progress.

1. Fragmented oversight. State oversight authority for brownfield cleanup is split between the Department of Toxic Substances Control (DTSC) and the State Water Resources Control Board (SWRCB), which has nine regional water quality control boards that each handle brownfields differently.[46] Additionally, the California Pollution Control Financing Agency has statutory authority to operate brownfield programs. The Legislative Analyst recently reported that a number of those programs duplicate the DTSC programs.[47] In addition to federal and state requirements, developers also must navigate local government entities and regulations. The inefficiencies that result from fragmentation and no "lead" agency drives up the costs of developing these sites.

In response, information clearinghouses were established in the early 1990s to provide information on various permit requirements. The United Agency Review of Hazardous Materials Release Sites Act was established in 1994 to allow responsible parties to request the DTSC to identify a single state or local entity to oversee site activities. Many observers have recommended centralizing regulatory authority in one

Brownfield Remediation: Best Practices

States that have adopted programs designed to encourage brownfield restoration have had dramatic results.

In Pennsylvania, over 25,000 new jobs have been created and 1,000 sites cleaned up as a result of its award-winning 1995 Land Recycling Program. The program provides clear and realistic clean-up standards, relief from liability, timely review of remediation work and financial assistance.

Financial assistance includes loans and grants to cities and developers for site assessment, remediation and infrastructure development and grants to local governments of up to $50,000 for local brownfield inventories. There also are tax credits for private firms based on employment increases.

The program includes an online technical manual with remediation procedures, a streamlined review process, an online directory of sites eligible for redevelopment, an online single application process for various funding options and multi-site cleanup agreements.

New Jersey saw a 29 percent increase in voluntary cleanups the first year after enacting its Industrial Sites Recovery Act. New Jersey provides liability relief, loans and grants of up to $2 million for local municipalities and up to $1 million for private developers and an online interactive map of brownfield sites. As of June 2001, $41 million in funding had been approved for more than 500 projects.

Michigan's Natural Resources Environmental Protection Act has generated 13,000 jobs, 1,500 housing units and $2.3 billion in private investment since 1994. One feature is the creation of Brownfield Redevelopment Financing Authorities where local governments establish brownfield zones that receive special financing and tax incentives.

Michigan initially dedicated $45 million in bond proceeds for assessment and site cleanup and $30 million in low interest loans to cities for site assessment, demolition and removal actions. In November 1998, voters approved a $675 million "Clean Michigan Initiative" bond of which $385 million is targeted for various brownfield programs. Michigan also provides tax incentives to attract private investment to brownfield remediation.

Source: Northeast-Midwest Institute. *Brownfields "State of the States": An End of Session Review of Initiatives and Program Impacts in the 50 States*. November 2001.

location and designating a lead agency to overcome the inefficiencies and costs associated with fragmentation.

New Jersey established a Brownfields Redevelopment Task Force to coordinate state activities, including marketing sites, regulatory programs, provision of infrastructure, and planning assistance to local governments. The task force includes members from state agencies and the public and receives staff support from the Office of State Planning.

2. Uncertain cleanup standards and liability. Cleaning up and redeveloping brownfield sites involves navigating a maze of federal, state and local laws and requirements. The process is time consuming and costly, often requiring specially trained lawyers and consultants. The risks involved have deterred all but the most determined local leaders and most developers and lenders.

California has enacted legislation to clarify the roles of state and local agencies in brownfield redevelopment and provide fiscal and regulatory incentives for developers and communities to clean up contaminated sites. The Polanco Act of 1990 gives redevelopment agencies the authority to require or undertake the investigation and cleanup of certain brownfields within redevelopment areas. It also provides redevelopment agencies, owners, occupants and lenders with immunity from being required to do further work on properties that have been cleaned up under a state oversight process. But only a handful of redevelopment agencies have utilized this tool to advance the restoration of brownfields in their areas.

The act was extended in January 2002 to cities and counties and requires Cal-EPA to adopt soil "screening values" to provide more certainty in brownfield transactions. The law also requires Cal-EPA to develop a "plain language" description of how to navigate California's complex regulatory process.[48] But critics assert that the State is not promoting the use of these laws by local agencies or administering them consistently. They also express concerns about how "screening values" will be developed. While many states have standards based on risk to human health, critics say that state regulators support standards intended to protect the ecosystem at large, which are far more stringent. The result could be impractical standards that further impede efforts to clean up brownfields.

Like many other states, California no longer requires all sites to be cleaned up to meet residential standards. In some cases, Cal-EPA permits parties to tailor the cleanup to the intended use of the site. But this practice is not implemented consistently and has not been codified. An official at the Department of Toxic Substances Control said that DTSC is opposed to guidelines based on the intended use of the site, fearing that risk can be underestimated.[49] But DTSC staff participated in and supported the development in Oakland of risk-based standards for the city and many other regulators reportedly employ human health risk assessments and land use considerations in their evaluations.

In another attempt to encourage projects, the Legislature, in 2000-01, approved $85 million for the Cleanup Loans and Environmental Assistance to Neighborhoods (CLEAN) program as "seed money" for assessing and cleaning up brownfields. But $77 million of the $85 million was transferred back to the General Fund in 2001-02 due to the State's budget crisis. Only $1 million is proposed for 2002-03.

Recently enacted federal legislation will provide liability relief for small businesses and prospective purchasers of brownfield sites and authorizes up to $200 million annually through Fiscal Year 2006 for grants to assess and clean up contaminated urban and industrial sites. $98 million had been authorized in Fiscal Year 2002 for brownfield assessments and cleanups. The new legislation amends the "Superfund" Act to provide grants to local governments to determine which sites should be on a brownfields inventory. It also amends the act to exempt property owners from contamination that migrates to their property from adjacent sites.[50]

Oakland Brownfields Progam

Oakland developed screening levels and standards for cleanup as part of an aggressive effort to recycle brownfields for affordable housing and other economic development. Innovative and determined local leaders forged relationships with cooperative state regulators assigned to their area who will "sign off" on projects that meet the standards Oakland has developed. But absent standardization, a similar project across the Bay involving a different state regulator could just as easily be denied.

To ensure safety, Oakland tracks contamination that is allowed to remain at sites by recording information in its Permit Tracking System. Permit applications for future work at the site must adequately address any risk from the residual contamination prior to approval.

Because of the real and perceived risks associated with brownfields, securing front-end and long-term financing has been difficult. Lenders often do not have the in-house expertise to adequately weigh environmental risks and fear ballooning cleanup costs and loan defaults. According to the Center for Land Recycling, 92 percent of the sites being cleaned up are the result of public-private partnerships that share the risk, fill financing gaps and attract additional capital. Finding 3 will discuss in more detail public-private partnerships and other ways to reduce the risks associated with affordable housing to attract additional capital.

3. No "brownfields" inventory. Information about the numbers and locations of brownfields and their potential uses is sketchy and often nonexistent. Local jurisdictions or property owners are not required to disclose information about the existence of brownfields and there is no central repository for information.

Most cities do not have a database of usable, vacant in-fill properties, let alone brownfields. In many cases, information about a property is known only to the owner who may prefer to "mothball" a property rather than learn the extent of contamination and be liable for cleanup costs.[51]

This lack of information is a paradox for developers and lenders. On the one hand, having site-specific information about the time and costs that cleanup would require could increase interest from a developer or lender. In reality, parties interested in a piece of property do not want the stigma associated with having it placed on a public list of brownfields. Many observers believe that listing sites eligible for financing incentives, as a way to market the properties, has more negative than positive connotations for the sites.[52]

One of the outcomes of not knowing which land is contaminated is that the potential for housing may be overstated in the local planning process.

A brownfield inventory developed by the New Jersey Department of Environmental Protection includes more than 1,300 sites described as underutilized or perceived to be contaminated. It is a subset of the complete inventory of known contaminated sites maintained by the department's Site Remediation Program, and continues to grow as new properties are identified as brownfield sites.[53] The brownfields inventory is distinct from the larger inventory to reduce concerns about stigma and encourage participation.

Information on New Jersey's brownfields is now available through an interactive map on the Internet. Users can identify where the brownfields are within a county or municipality and the proximity to transportation and infrastructure.

California should follow the lead of states like Pennsylvania, New Jersey, Michigan and others that have implemented aggressive brownfield programs to make land available for affordable housing, rebuild local economies and revive community spirit. It should implement a comprehensive state strategy that makes

Effective Brownfield Programs in Other States

Five states leading the way with aggressive brownfield programs are: Maryland, Massachusetts, Michigan, New Jersey and Pennsylvania. These states have made a compelling economic case for state spending on brownfields -- arguing that a dollar of state spending produces about 10 to 100 times more dollars in economic benefits. Success in these states is being driven by several factors:

- Having state leaders provide clear and public support for the importance of brownfield remediation in advancing the state's quality of life and economy.
- Working to eliminate all remaining barriers to brownfield redevelopment and improving the full package of incentives, assistance, and liability reduction offered to project proponents. State actions to address liability concerns are working, but the federal liability under the Superfund statute still biases some decisions in favor of "greenfield" development and sprawl.
- Broadening state brownfields programs to include involvement of state planning agencies and other appropriate state and local government agencies. It is imperative to have strong involvement of state organizations besides environmental regulatory agencies.
- Ensuring the protections of public health while shifting emphasis to the broader economic development value of brownfield sites.

Source: Stephanie Shakofsky, executive director, California Center for Land Recycling, testimony to Little Hoover Commission, June 28, 2001.

brownfield restoration a priority, including streamlining state oversight, reducing risks and providing incentives to invest in these properties.

The California Center for Land Recycling provides training, technical assistance and small grants to help communities restore brownfields. It is a resource for information on good local efforts underway in California.[54]

Recommendation 2: California should seize the opportunity that urban brownfields present for increasing the supply of affordable housing by establishing policies and incentives that prioritize the reuse of these sites. The State should:

- ***Require local jurisdictions to identify potential sites.*** Cities and counties should identify and characterize potentially contaminated infill sites where affordable housing could be developed and publish an online inventory of sites. Local inventories should be reported to the State and identified in housing elements.

- ***Establish a statewide database.*** The Department of Toxic Substances Control should assemble the information developed locally into a statewide database. The database should be used to determine how much of California's housing demand could be met by redeveloping sites and where recycling would provide the greatest opportunities for increasing the stock of affordable housing.

- ***Develop state guidelines and streamline the approval process.*** The State should establish guidelines for cleanup that are based on the intended use for the site. Guidelines should provide regulatory certainty and protection from protracted and costly litigation when environmental impacts and other conditions have been met. Additionally, the State should provide local governments a clear definition of brownfields, and simplify and "fast track" the approvals process.

- ***Provide financial and technical assistance.*** The State should increase grants, loans and proceeds from housing bonds to local jurisdictions and private developers for site assessment and inventory development. Priority for funding should be given for sites that could be zoned for housing. The Department of Toxic Substances Control should

Should the State Buy and Clean Up Brownfields?

It has been suggested that the State consider buying and cleaning up some of California's brownfields as a way to advance the reuse of sites that are particularly difficult to market.

The State could use bond issues to buy and clean up land, then lease it to developers for affordable housing. By scheduling the rents appropriately, the State could use any excess cash flow to repay the bonds.

The State also could sell sites it has cleaned up and provide liability protection to the new owners. Whether the State could recover its costs would depend on the State's capacity to prudently buy land, clean it up, negotiate with developers and other factors.

The Commission has not examined these options, but believes they are worth exploring.

conduct educational conferences and provide technical assistance to redevelopment agencies, cities, and counties to accomplish goals for brownfield development, including improving the capacity of communities to elicit public participation in decisionmaking regarding redevelopment projects.

- ***Audit progress.*** The Department of Toxic Substances Control should review and issue "report cards" on the progress of local jurisdictions in meeting goals for brownfield development. The department should focus first on those communities with the greatest number of brownfields and largest need for affordable housing.

To Lower Risk and Attract New Capital

Finding 3: Diminished investment incentives, coupled with uncertainty and perceived risk, have quashed private investment in affordable housing – particularly multifamily housing.

Over time, increasing the supply of land available for housing will reduce the costs associated with building all types of housing. The construction of affordable housing also has been limited by the low or negative rate of return to investors – requiring them to rely on subsidies to make the projects "pencil out." Subsidies are essential in a housing market with inflated prices, and making the most of subsidies is described in the next section. But there also is the potential to draw more investors into the market by accurately identifying and reducing the risks associated with affordable housing.

The Tax Reform Act of 1986 removed key incentives for private investment in multifamily housing by increasing the time it takes an investor to depreciate residential property and limiting tax deductions on rental property. In 1986, 148,085 multifamily housing permits were issued, representing 47 percent of the total residential permits issued. In 2000, the number of permits issued fell to just 36,000 or 25 percent of total permits. The federal Low-Income Housing Tax Credit program was established in 1987, but has never achieved pre-1986 levels of multifamily development. For most of the 1990s, the percentage of multifamily building permits remained below 20 percent of the total permits issued.

Some observers believe that returning the depreciation and passive loss provisions to their pre-1986 format would help solve the affordability crisis in California and the rest of the nation. The Legislature in 2001 petitioned the President and Congress to review the federal tax law for rental housing and enact new incentives for investment in multifamily housing.[55] But Congress recently increased the federal tax credit allocation cap and is not expected to consider further reforms soon.

Community Reinvestment Activities

The vast majority of private capital invested in subsidized affordable housing comes from the banking industry as a result of the federal Community Reinvestment Act (CRA), which requires banks, thrifts and other lenders to invest in low- and moderate-income neighborhoods. In January 1995, the CRA was revised to encourage environmental cleanup or redevelopment of brownfields.

The four federal banking institutions with oversight authority for depository lenders evaluate annually the community reinvestment performance of banks and savings institutions. Poor performance can affect the ability of those institutions to engage in activities such as expansions, mergers and acquisitions.

Reasons Insurers Should Make Community Investments

The Insurance Commissioner described the following benefits of community investments:

1. COIN is not about charity. COIN promotes safe, sound community investments that earn profits for insurance companies. Many COIN-type investments are relatively low risk.
2. Community investment is good corporate citizenship and good public relations; it demonstrates that a company that profits from doing business in a community is willing to give something back by investing in that community.
3. Community investment establishes a positive business relationship with the fastest growing demographic markets in the nation. It is an investment in future customers.
4. A voluntary community investment program such as COIN provides the flexibility, simplicity, and industry discretion a mandatory program does not offer.
5. A successful COIN program reduces or eliminates the need for a CRA-type mandated community investment program for the insurance industry.

Source: Press Release, CA Department of Insurance, August 6, 2001.

Large institutional investors such as pension funds and insurance companies also have been considered potential sources of capital by policy-makers. In 1995, the California Organized Investment Network (COIN) was established, at the request of the insurance industry, as an alternative to state legislation that would have required insurance companies to invest in low-income communities, similar to the CRA. In 2000, COIN began a limited tax credit program for insurance companies that invest in community development projects. By the end of 2000, insurance companies had made 169 investments in low-income communities, totaling $477 million.

In 2001, Insurance Commissioner Harry Low publicly called on insurance companies doing business in California to invest in low-income communities and to establish annual investment goals. He pointed out that less than 10 percent of the insurance companies doing business in California make community investments.

It is estimated that only 1 percent of domestic private equity capital is targeted toward real estate development and businesses in core urban areas.[56] The Public Employees Retirement System (PERS) and the State Teachers Retirement Systems (STRS) have been encouraged by State Treasurer Philip Angelides and others to invest in affordable housing in California. PERS has committed to investing $150 million in 2002. STRS has also committed to investing $150 million and is currently negotiating contracts.

Absent tax incentives – or a mandate like CRA – private investors seek risk-adjusted rates of return that are competitive with other investment opportunities to attract them to multifamily housing. But in most California markets, average apartment rents are far below the levels necessary to provide competitive rates of return.

Insurance companies and pension funds are resistant to affordable housing investments based on their fiduciary requirement to maximize returns to shareholders, the perception that affordable housing is a fiscal loser and the risks involved in the affordable housing development process. In both industries the solution to date seems to be the development of mixed-use projects and teaming with top-notch nonprofit developers who have the staff and expertise to navigate the marketplace.

In July 2001, the California Environmental Redevelopment Fund (CERF) was established as part of the Bay Area Community Capital Investment Initiative to attract capital from corporations and financial institutions for restoration of brownfields statewide. To date, the fund has attracted $40 million in investment capital and is establishing specific development projects.

The Development Approvals Process

Proposition 13 capped property taxes and limited the ability of communities to provide the infrastructure necessary to serve new development. Developer fees and exactions increased in numbers and cost to fill the gap, further increasing the already high cost of housing. National surveys show that California leads the nation in imposing fees on new residential development.[57] Cities and counties typically charge more than two dozen types of development–related fees, which vary widely from jurisdiction to jurisdiction, often with no explicit rationale. They average $20,000 to $30,000 per unit and account for more than 15 percent of new home prices in jurisdictions providing substantial shares of affordable housing.[58]

A study prepared for the Business, Transportation and Housing Agency found that the systems used by local jurisdictions to set and administer fees are “opaque, inconsistent and profoundly inefficient.” The authors asserted that development fees are higher than necessary, in part because jurisdictions do not undertake long-term capital improvement plans and programs. They recommended requiring jurisdictions to prepare “realistic” capital improvement plans as part of their local general plans and that the State make revenue sharing contingent upon their doing so. They also made recommendations for minimizing the impact of fees on affordable housing specifically and making development fees more transparent. [59]

The Commission identified three opportunities for the State to reduce risks and increase certainty to attract additional private investment in affordable housing.

1. Promote investment partnerships to share risk.

Public-private investment partnerships have the potential to lower the risks and attract private capital to affordable housing. The Community Capital Investment Initiative in the Bay Area – a public/private/community partnership – has reduced risks associated with affordable housing and other economic development activities through developing investment pools, providing leadership and building capacity locally. Comprised of three funds that will invest in housing, business and environmental cleanup, sponsors expect investment returns in the mid- to high teens. But they acknowledge that in an inflated market, most affordable housing is only viable as a component of mixed-use projects. Of the $50 million invested in the real estate fund, more than $45 million is from the CRA investments of banks. The State could provide technical assistance to help local leaders pursue partnership opportunities.

> **Michigan Capital Fund**
>
> The Michigan Capital Fund was created in 1993 by the Michigan State Housing Development Authority as a nonprofit entity to address the lack of interest in investing in certain kinds of projects eligible under the Low Income Housing Task Credit program.
>
> Dual purposes of the fund were to attract equity for worthwhile affordable housing developments that might otherwise lack equity investment and to encourage Michigan corporations and lending institutions to make housing investments within the state while achieving attractive rates of return.
>
> Investors pool their money to create a fund that invests as a limited partnership in specific projects.
>
> The state of Michigan allocated a $500,000 repayable loan to the fund as seed money. This loan was repaid in two years. To date, the program has had seven different funds ranging in size from $10 million to $25 million and its investments have created over 5,000 affordable apartments.
>
> Source: Jeanne Peterson, California Tax Credit Allocation Committee. Personal communication. February 7, 2002.

2. Streamline the development approvals process.

The State could set standards for establishing fees and provide technical assistance to communities to use technology to streamline, automate and Internet-enable the building permit process as a way to rationalize and lower costs. It could provide technical assistance to help communities implement model permit streamlining programs like those in the Joint Venture Silicon Valley Smart Permit Program. The goal of these efforts should be to lower costs and make more housing available.

San Carlos is one of eight pilot cities that participated in the Smart Permit Program. In addition to using technology to improve the development review and permit process, San Carlos established a development review committee to assist developers. The committee, which includes an attorney, police chief, city manager and others, meets with developers at the beginning of a project to address pertinent issues, allay concerns and provide information about the process. Specifically, the committee tells developers what permits they will need, how long it will take to obtain them and what it will cost. In turn, the city gets better plans and more efficiency.

In the development of affordable housing, San Carlos has recognized the importance of community outreach and education. City officials encourage attendance at meetings to discuss affordable housing projects, address misconceptions about affordable housing and respond to the needs and concerns of the community. Officials later distribute written copies of the questions and answers to meeting attendees. As a result, projects advance more quickly, neighborhood concerns are addressed and opposition is reduced.[60]

3. Identify new sources of private capital.

Through education and outreach the State could help to dispel the widely held belief that affordable housing is a financial loser. Using the experiences of financial institutions that participate in the Community Reinvestment Act like Bank of America, Washington Mutual Bank and Wells Fargo Bank, the State could educate potential investors about the elements of successful investments in affordable housing. It could "market" the returns – financial and social – that accrue to investors in affordable housing. Its efforts could be directed at individual investors as well as other large institutional investors like pension funds and insurance companies.

Recommendation 3: The State should implement policies and promote practices to increase private investment in affordable housing. Specifically, the State should:

- ***Promote partnerships.*** The State should educate leaders from the public and private sectors about the potential of partnerships like the Community Capital Investment Initiative in the Bay Area to lower conflict, share risk and cost, and increase available capital. It should assist local and regional government officials to develop the skills and expertise to develop similar partnerships among businesses, residents, other local officials, and state and federal agencies.

- ***Increase the efficiency and certainty of the project approval process:***

  - ✓ Local jurisdictions should be encouraged to consolidate fee schedules, develop one-stop permit centers and provide for online review of projects.

  - ✓ Local jurisdictions should be encouraged to extend payments for development fees over time to reduce the present-value costs that inflate the bottom line of housing projects and burden homebuyers and renters.

  - ✓ The State should set standards for establishing fees as a way to reduce and rationalize their costs.

- ***Identify new sources of capital.*** The State Treasurer should convene a task force to identify new sources of private capital for investment in affordable housing. The task force should recommend a strategy for outreach and education about the financial and social returns achievable from affordable housing investments. Participants should include banks, insurance companies, pension funds, state housing agencies, the Business Roundtable, housing developers and advocates.

Subsidizing Affordable Housing: Making the Most of Available Subsidies

Finding 4: Public subsidies for affordable housing are inconsistent, unreliable and are not allocated in ways that provide the greatest value.

Over time, making adequate land available, reducing risks for investors and attracting more capital will increase the supply of affordable housing and reduce the need for direct subsidies. But until those strategies take hold, subsidies are essential to providing housing at prices that low-income Californians can afford.

Affordable housing is subsidized by federal and state grants and loans, tax increments from redevelopment agencies, private investment – mostly from the CRA activities of banks – and through quota requirements placed on new development. But these funding streams have been inconsistent and unreliable, impeding efforts to build affordable housing in California.

To make the most of available subsidies the Commission believes they should be reliable and, in some cases, shared by the larger community. Subsidies also should be easy to access, which is discussed in Finding 5.

Declining Federal Subsidies

The federal government provides the bulk of funding for low-income housing in California and the nation. But this support has declined dramatically since the late 1970s when the federal Department of Housing and Urban Development (HUD) committed to expand rental assistance nationally to an average of 260,000 new households annually. From 1982 through 1997, the average number of new households receiving assistance fell to approximately 70,000 annually.[61]

California receives less federal housing assistance per person in poverty than all but one of the 10 largest states. On average in 1999 the federal government spent $286 on housing assistance for each person in poverty. But California only received $171 per person, 40 percent less than the national average. Reasons for the disparity include an increase in the number of California households eligible for assistance, limited growth in federal assistance and outdated funding formulas.[62]

California receives the largest allocation of federal tax credits of all states and approximately 10 percent of the total nationwide. In 2000-01, $71.6 million in federal tax credits were issued in California. But these amounts are still inadequate to meet the demand and the program is typically oversubscribed by four-to-one.[63]

In 2001, the Legislature presented the federal government with a resolution requesting it to raise the cap on the federal Low-Income Tax Credit Program.[64] Because the federal cap was recently raised, state officials are not optimistic that it will be increased again in the near future.

The California Budget Project reports that a recent survey of 20 local housing authorities found 371,740 families were on waiting lists for assistance under the Section 8 program, more than three times the 104,133 families receiving assistance. The demand may actually be much higher because many agencies periodically close waiting lists to new applicants or hold lotteries to determine who will be put on waiting lists.

In many areas of California, market rents are significantly higher than the "fair market rent" value of housing certificate vouchers (formerly known as Section 8 vouchers). As a result, many voucher recipients are unable to find landlords willing to accept their vouchers and must return them unused. A recently released HUD study showed that nationally, 31 percent of voucher holders in large metropolitan areas are unable to find housing with their vouchers.[65]

Nationally, many federally subsidized housing units are reaching the expiration dates of their contracts, risking their conversion to market rates. In the last four years, 142,000 of 1.3 million apartments subsidized by federal dollars have been removed from the low-income housing stock. Another million are threatened, and a quarter of them could disappear in the next decade, according to the National Housing Trust.[66]

California leads the way with more than 20,000 apartments lost in the last four years. The Department of Housing and Community Development estimates that more than 180,000 units may be at risk of conversion from affordable to market rates over the next decade.

Sacramento Tenants Fight Back

As the neighborhoods surrounding their low-income apartments gentrified, modest apartments rented by elderly tenants, single mothers and low-wage workers suddenly became prime real estate. Property owners anxious to cash in on rising property values and at the end of their federal requirement to maintain affordability began issuing notices of pending sales and staggering rent increases.

Tenants in four Sacramento area apartment complexes made history by fighting back, charging violations of state and federal notification laws. The new buyer settled out of court and agreed to preserve the federal subsidies for current but not all future tenants.

Declining State Subsidies

During the 1980s, California implemented a series of innovative housing programs and provided substantial funding for affordable housing. In 1985, it established the first state housing trust fund. In 1987, it created a state supplement to the federal low-income housing tax credit. And from 1988 to 1990, California voters passed three affordable housing bonds, totaling $600 million.[67]

Still, state spending on housing dropped during the 1990s from 0.7 percent of total general fund spending in 1990-91 to 0.2 percent of total spending in 1999-00. In 1999, the California Budget Project reported that state funding allocated to housing and related programs was less than half the 1989 amount.[68]

In 2000-01, the State increased its support for affordable housing by $292 million, an increase of more than 350 percent. A large portion of the funds, $188 million, was for the Multifamily Housing Program, which provides deferred payment loans to assist the new construction, rehabilitation and preservation of permanent and transitional rental housing for low-income households. Another $110 million was budgeted for the Jobs-Housing Balance Improvement Program which was designed to reward local governments for increasing housing production, particularly where there are more jobs than homes.

But the subsequent state budget crisis in 2001 resulted in a transfer of $45 million in Multifamily Housing Program funds remaining from the 2000-01 budget to the General Fund and the elimination of $23 million appropriated for the program in 2001-02. All but $5.9 million was eliminated from the Jobs Housing Balance Improvement Program. No funding is proposed for the programs in 2002-03.[69] According to HCD, many eligible jurisdictions were on track to qualify for the incentive funding.[70]

The State recently raised the amount of state tax credits available from $50 million to $70 million. Under current law, only projects that qualify for federal tax credits are eligible for

Housing and Emergency Trust Fund Act of 2002

SB 1227, introduced by Senator John Burton, was passed by the Legislature and signed by the Governor in April 2002. It places a $2.1 billion bond measure on the November ballot to fund State housing programs.

More than $900 million of the bond proceeds would fund the State's Multifamily Housing Program which provides grants and loans for the development of low and very-low income housing.

The bond also would fund programs that target the homeless, farmworkers, students, the disabled and other special needs populations. It also would provide loan assistance for first-time homebuyers.

Additionally, the bond would fund the Jobs-Housing Balance Improvement Account, which rewards local governments that produce housing near jobs, and provides money for pending legislation enacting a program that provides matching grants for local jurisdictions with housing trust funds.

Source: SB 1227.

state tax credits. Tax Credit Allocation Committee determinations are made only after projects have obtained commitments from all other funding sources. Because of the scarcity of federal and state tax credits, state officials do not want to commit to projects that may not be successful in obtaining other sources of funding required to make them viable. The result is that projects that have been in the works for several years – representing hours of staff time and costs – can be derailed because of a shortage of tax credits, not because they are inferior proposals. For projects that are funded, TCAC investments appear to be cost-effective. In 2000, 5,667 units of affordable housing in 81 projects were funded with $106 million in state and federal tax credits, representing a subsidy of approximately $34,000 per unit.[71]

The Role of Local Government Subsidies

Most local support for housing comes from local redevelopment agencies. After the federal government, redevelopment agencies are the largest source of funding for affordable housing in the state. State law requires agencies to spend 20 percent of their property tax revenues on low- and moderate-income housing. Some agencies, like those in San Francisco and San Jose, are allocating higher amounts for housing. Redevelopment agency expenditures for affordable housing programs totaled $343.2 million in 2000-01.

Many redevelopment areas established between 1960 and the mid-1970s are approaching the expiration of their 40-year time limits. Some 200 of the 800 redevelopment areas statewide are due to expire soon. Legislation enacted in 2002 permits these agencies to continue for 10 years if the areas are still blighted and the agency has not accumulated an excess surplus in its housing fund.

Policy-makers and advocates also have proposed that redevelopment law be amended to increase the set-aside required for affordable housing.

The Costs of Infrastructure

Before the passage of Proposition 13, the bulk of the costs of infrastructure for new development were paid for by local property taxes. In the years since Proposition 13 capped property taxes, developer fees have assumed an increasingly important role in the cost of housing – particularly affordable housing. Finding 3 described how development fees – levied to provide the infrastructure required to serve new development – drive up the cost of all housing. The Commission made recommendations for ways to streamline the development approval process to reduce the risk and cost to developers.

The State faced a similar situation when Proposition 13 severely limited the ability of schools to raise capital funds. In response, the State stepped in and provided grants to districts for new facilities. In some cases it asked districts to contribute a small percentage of the cost; districts with the highest needs could apply for 100 percent financing.

The California Infrastructure and Economic Development Bank was created in 1994 to promote economic revitalization and to help fund infrastructure necessary to future development. The Infrastructure State Revolving Fund (ISRF), one of the Bank's two current programs, provides low-cost financing to public agencies for a wide variety of infrastructure and public improvements. Cities, counties, special districts, joint powers authorities and redevelopment agencies are all eligible to apply for funds. The program received a combined total of $475 million in funding in the 1998-99 and 1999-00 state budgets. In 2001, $277 million was redirected back to the General Fund. To date, $120 million has been committed to specific projects and the Bank intends to issue revenue bonds to leverage additional funding for the program.

In a survey conducted for state housing agencies, 35 percent of responding jurisdictions reported that they reduce or waive fees for affordable housing projects. For example, the Sacramento Regional County Sanitation District recently voted to implement a tiered fee schedule that more accurately reflects the costs of infrastructure. It reduces connection fees for in-fill developments and raises them for new developments that are expected to require a $1.3 billion network of large new pipelines. Under the new plan, urbanized areas will pay only for that portion of new pipelines that will benefit them.[72]

Toward Consistent, Reliable and Efficient Funding

Funding for affordable housing has historically been inconsistent and unreliable. These challenges have been coupled with those presented by public policies that limit the ability of local jurisdictions to provide infrastructure, resulting in fees that raise the cost of affordable housing beyond levels that are economically feasible for developers.

The Commission has identified three opportunities for the State to stabilize funding for affordable housing and to fund some of the infrastructure-related costs for low- and very low-income housing.

1. Consistent and reliable funding. In 1985, California established the first state housing trust fund. The California Housing Trust Fund was intended to be a consistent, reliable source of funding for state housing programs administered by HCD, but never fulfilled its promise. The fund receives a portion of the proceeds from oil produced on state tidelands, but over time revenues have been diverted to higher priority programs. The trust fund currently receives less than $2 million annually.

Some three dozen states have trust funds. In Florida, for example, a documentary stamp tax consistently provides $120 million a year to a housing trust fund. The documentary stamp tax, which is also called a real estate transfer tax, is the most common revenue source for state housing trust funds. Some states also capture interest from various state-held funds, real estate escrow or mortgage escrow accounts and document recording fees. Still other states dedicate income taxes, unclaimed lottery earnings, unused federal Temporary Assistance to Needy Families (TANF) funds and unused HUD Section 8 program reserves.[73]

In California, 13 cities have established housing trust funds. The first was established in 1989 in Sacramento. It is funded through a housing linkage fee on non-residential construction and has generated about $10 million since its inception. San Diego has a similar developer fee-based housing fund that has generated $46.2 million since its inception in 1991. The Housing Trust Fund of Santa Clara raised $20 million in 2001 with more than two-thirds of the funding from the private sector.

Los Angeles has launched a major initiative to establish a $100 million housing trust fund. The plan utilizes various sources to provide stable and permanent funding for affordable housing development. Funding sources include redirection of community development block grants, money from the sale of city property, an increase in the share of redevelopment property taxes from 20 to 25 percent, delinquent city tax revenue, tobacco settlement funds and increases in vehicle license fees.

But the State has not provided leadership to encourage other communities to establish local trust funds or established a mechanism to use state dollars to encourage more local investment.

San Mateo County Housing Trust Fund

The San Mateo County Housing Trust Fund, a partnership of the County Office of Housing, HUD and the Peninsula Community Foundation outlined a goal in October 2001 to generate $20 million. Possible funding sources include a sales tax increase, parcel tax, real estate transfer tax, hotel tax and a general obligation bond. A one-time initial capitalization from the community general fund was also suggested. Other sources suggested as possibilities include commercial linkage fees, proceeds from the sale of surplus property, inclusionary zoning fees, document recording fees, interest on tenant security deposits, building permit fees and other business fees.

Source: A Housing Trust for San Mateo County: A Report to Peninsula Interfaith Action and the Advisory Committee, August 2001.

2. Efficient allocation of scarce resources. State housing officials assert that the federal and state Low-Income Tax Credit Programs are the most important subsidy programs. Virtually all affordable rental housing requires tax credit subsidies and the tax credit can comprise as much as 60 percent of the total project funding.[74] But many qualified projects are turned away at the door of the state Tax Credit Allocation Committee because of the limited number of tax credits available. On average, only one in four qualified applicants is awarded tax credits.

Moreover, critics assert that most state subsidies are allocated on a project-by-project basis with little consideration of local and regional needs and little coordination among the state agencies. State policies require that funds be allocated equitably on a geographic basis. State agencies set aside portions of funds for counties identified as having severe housing problems. But these criteria do not ensure that scarce resources are directed to where the needs are greatest, and they are not aligned with the state-mandated process for projecting housing needs. Also, state agencies make funding decisions consecutively rather than simultaneously, increasing time, costs and complexities for developers. As a result, costs of projects grow and the ability to target state dollars to the communities with the greatest needs is diminished.

Housing Trust Funds in Other States

Since the mid-1980s, housing trust funds have collectively invested about $1.5 billion to create and preserve close to 200,000 units of affordable housing. There are more than 100 active trust funds -- both local and state -- that generate more than $315 million a year in revenue.

Florida -- Florida initially generated its trust fund revenues through a 1992 increase of $.10 per $100 valuation in its documentary stamp tax. In 1996-97, the stamp tax was increased by an additional $.10 per $100. The housing trust fund generates approximately $120 million annually.

Arizona -- Arizona's housing trust fund receives its revenue from a 55 percent allocation of unclaimed property deposits, interest on unexpended funds, loan repayments, and recaptured funds. Since its inception, the fund has awarded more than $31 million dollars, benefiting more than 20,000 households.

Illinois -- The Illinois housing trust fund revenues are generated from the transfer tax fee charged on all residential real estate transactions -- $.50 per $500. In 1998, the fund awarded $21 million for single family and multifamily projects.

Oregon -- Oregon's housing trust fund is funded with interest earned on renter security deposits. In 1997-98 it generated $4.5 million.

New Jersey -- The New Jersey housing trust fund is funded through a real estate transfer tax. It generated $29 million in 1999-00.

Washington -- Washington funds its housing trust fund through dedicated revenues and appropriations from its capital budget. In 1999-00, it funded $62 million in general affordable housing programs, $5 million for homeless family programs and $8 million in farmworker housing programs.

Source: Michael A. Stegman, Urban Land Institute. *State & Local Affordable Housing Programs: A Rich Tapestry,* 1999 and California Budget Project, *Locked Out: California's Affordable Housing Crisis*. May 2000.

Pursuing adequate subsidies and maximizing the use of available subsidies should be the State's goals. The State could continue to advocate for increased federal assistance to reflect the higher cost of housing and need in California. But it could prioritize the backlog of qualified projects that are stymied because of insufficient tax credits by allocating other available subsidies to fill the gaps in order to clear the backlog and advance those projects.

3. Sharing the burden. In Finding 3 the Commission made recommendations for ways to reduce costs by increasing the efficiency and certainty of the project approval process. If some fees, specifically for low- and very low-income housing, also were shifted to the State and shared by the larger community, development costs for those projects could be reduced even further.

The State could reform its policies to shift the burden of infrastructure costs for low- and very-low income housing away from individual developments to the State or, in this case, to the larger community. The following are among the options that could be considered:

- ✓ The State could assume some or all of the infrastructure-related costs for projects that meet specific criteria for affordability.
- ✓ Communities could be encouraged to assess a modest increase on all property owners to cover infrastructure-related development fees for services such as sewer and water for affordable housing.
- ✓ Local agencies could be encouraged to assess the actual costs of providing infrastructure to new developments and in-fill developments and implement fee schedules that more accurately reflect those costs.
- ✓ The State could give priority for Infrastructure Bank Loans to projects that support affordable housing and that are aligned with local and regional goals for housing.

Recommendation 4: The State should identify permanent, dedicated sources of funding for the California Housing Trust Fund, promote local housing trust funds and enact policies to share infrastructure-related costs for affordable housing. Specifically, the State should:

- ❑ ***Identify a permanent, dedicated source of funding for the California Housing Trust Fund.*** Revenue sources that could be considered include: portions of real estate transfer taxes, document recording fees, bank and corporation taxes, interest from real estate escrow accounts, and others. The State should promote the establishment of local housing trust funds and give priority for state trust fund allocations to jurisdictions with matching local trust funds.

- ***Shift infrastructure costs.*** The State should pay portions of infrastructure costs for affordable housing projects meeting specific criteria, in areas with the greatest needs. For example, future school bond measures could include a fund to pay the local school impact fees for affordable housing projects. Other mechanisms could include returning an increased share of sales tax revenue to jurisdictions that reduce development fees, providing Infrastructure Bank loan incentives for jurisdictions that reduce fees, or earmarking fines from EPA enforcement actions with a nexus to infrastructure. It could exempt from school impact fees affordable projects serving populations, like seniors, that do not access schools.

The Housing Bond: Evaluating its Effectiveness

The State did not conduct an analysis of the impact of the three housing bonds passed between 1988 and 1990. If the voters approve the proposed $2.1 billion housing bond in the November 2002 election, the Legislature should require a rigorous, independent evaluation of its effectiveness. Specifically, the evaluation should provide an analysis of who received the funds, the impact of the funds on specific projects and the statewide housing shortage, and provide policy makers with guidance for the use of future housing bond funds.

- ***Spread infrastructure costs.*** The State should explore ways to spread infrastructure costs associated with low-income housing developments to the larger community.

- ***Allocate subsidies efficiently.*** As COGs play a larger role in advancing housing goals, regional planning processes and statewide needs should influence how housing funds are allocated. Decisions regarding funding should be coordinated among state agencies and COGs.

- ***Focus on tax credits.*** The State should more aggressively advocate for additional increases in the federal tax credit program. To immediately increase the supply of affordable housing, the State should allocate any increases in state funding for affordable housing to qualified projects that are ready to begin construction but are constrained by the limited supply of tax credits.

Subsidizing Affordable Housing: Making Subsidies Easy to Access

Finding 5: Developers of affordable housing must patch together funding from multiple and disparate sources, delaying development and increasing costs.

Three state entities – the Department of Housing and Community Development, the California Housing Finance Agency and the Tax Credit Allocation Committee in the Treasurer's Office – administer most state housing programs.

For low- and very low-income housing projects, state subsidies can account for as much as 60 percent of the total funding. Projects often require subsidies from all three agencies and numerous other public and private sources. It is not uncommon for an affordable housing project to require 10 to 12 public and private funding sources.

Fragmented responsibility for the administration of state housing programs means multiple applications and multiple eligibility, monitoring and reporting criteria – all of which increase time and costs for project sponsors.

Three of the largest nonprofit developers of affordable housing in California said that fragmentation among the state agencies is a "huge" problem.

In 1995, in response to concerns over the administration of state housing programs, a Housing Task Force was established and charged with making recommendations to improve the coordination of resources offered by local, state, federal and private sources. It also was charged with recommending whether or how to reorganize the State's housing programs and recommending how to create and implement performance standards for the State's housing programs.

The task force issued two reports to the Legislature in 1995 and a status report on the implementation of its recommendations in January 1997.[75]

The director of the Department of Housing and Community Development testified that the improved coordination described in the final report of the task force has been maintained. State officials and developers of affordable housing agree that the state agencies are cooperating and communicating with each other more than ever before and that funding cycles are better coordinated. But much more remains to be done to make access to subsidies easier for developers and to streamline monitoring of subsidized projects.

Case Study: Grayson Creek Apartments

Grayson Creek is an affordable, 70-unit multifamily housing complex under construction in Pleasant Hill. To make the apartment project "pencil out," BRIDGE Housing, the nonprofit housing developer, required a complex mix of federal, state, local and private financing sources, including:

1. City of Pleasant Hill Redevelopment Agency
2. Contra Costa County Community Development Department (acquisition/construction financing)
3. California Housing Finance Agency (CHFA)/California Debt Limitation Allocation Committee (CDLAC) - (tax exempt bonds)
4. California Department of Housing and Community Development (HCD) - Multifamily Housing Program
5. Union Bank (construction loan)
6. California Equity Fund (tax credit investor)
7. Federal Home Loan Bank/World Savings Bank (Affordable Housing Program)
8. Low-Income Housing Fund (predevelopment loan)
9. Northern California Community Loan Fund (predevelopment loan)

Project Timeline

The land was purchased in 1998 from the county and a private landowner. BRIDGE attempted to qualify for 9 percent low-income tax credits, once in 1999 and twice in 2000 through the California Tax Credit Allocation Committee (TCAC). The project scored well in the extremely competitive process but was unsuccessful because it was not located in a designated redevelopment area.

BRIDGE also applied for financing through the Affordable Housing Program offered by the Federal Home Loan Bank and World Savings Bank, once in 1998 and twice in 1999. On the third try, the developer was successful.

In 2001, BRIDGE applied for and was allocated $4 million through HCD's Multifamily Housing Program. That same year, BRIDGE received 4 percent federal tax credits through TCAC, secured by tax exempt bonds through CHFA. Additional funding from the county and the city enabled BRIDGE to keep rent levels very low. Construction began in late 2001 with expected completion in early 2003.

Applications -- Costs and Difficulties

BRIDGE submitted seven applications for the project, three to TCAC for 9 percent tax credits, one to TCAC for 4 percent tax credits, one to HCD, one to CHFA, and one to CDLAC. Application fees totaled $4,500, (this includes a $1,000 savings on each of the four TCAC applications from waivers provided by the local reviewing agency). Additionally, each state application is different – not only are the forms different, but the content varies among agencies. For example, rent levels for TCAC-funded projects are calculated according to Area Median Income, while rent levels for HCD-funded projects are calculated according to State Median Income. Other variations include developer fee allowances and market comparables. Staff time per application averaged about 100 hours, so the total staff time spent on applications was 700 hours for this project.

Other Added Costs

Due to delays in qualifying for various financing programs, the project cost grew from $9 million to $11 million. Also, the $4 million grant from HCD required payment of state prevailing wages for construction trades, adding $1.5 million to the project budget.

Not qualifying for the TCAC 9 percent credits in 1999 resulted in a construction delay of two years, during which time construction costs increased by $500,000. The delays also resulted in approximately $75,000 in other costs, such as interest payments on predevelopment loans.

Source: BRIDGE Housing Corporation. Personal Communication. January 14, 2002.

The following are among the problems described by affordable housing developers:

- ***Multiple applications.*** Developers applying for state funds must submit separate applications for each funding source. An executive of a large non-profit builder of affordable housing said that applications are as long as 300 pages, often requiring redundant information but "ranking" similar elements differently. She described the process as a "colossal waste of time for us and for the State."[76]

  While the director of HCD indicated that applications had been streamlined, staff conceded agencies were still far from accomplishing that goal, which also was a recommendation of the Housing Task Force.

- ***Changing criteria.*** Developers assert that the State constantly changes application scoring criteria. As a result, projects that have been in the predevelopment phase and are finally ready to apply for state financing become financially infeasible under the new scoring criteria.

- ***Redundant monitoring.*** Each year subsidized projects are monitored by the state agency that provided funding to ensure the project continues to meet the requirements of the original grant or loan. Every project receives a monitoring visit from each state agency that subsidizes it, creating inefficiencies and increasing costs for the developer and the State.

  The Housing Task Force recommended that a lead agency be identified for each project to avoid duplicative oversight. Developers concur with the recommendation. But to date, there is little or no coordination and sharing of resources. The State's housing director acknowledged the need and said that agencies are attempting to better coordinate their monitoring activities.[77]

- ***Cumbersome bureaucracies.*** Nonprofit developers lamented the generally "torturous" process of accessing state subsidies – whether from one agency or three. One said that "HCD makes working with HUD look easy."[78] Developers complained about the time required to process loan applications and even to cut checks once funds have been awarded. As a result, nonprofits often have to borrow money to pay contractors while waiting for state funds, further increasing project costs. The State could establish a mechanism to provide assurance to lenders that funding is forthcoming.

Making Access to Subsidies Easy

Executives of large nonprofit affordable housing builders in California told the Commission that the production programs of the state agencies should be consolidated or at least much better coordinated.

Based on responses to a statewide survey of nonprofit housing developers, the Institute of Urban and Regional Development at the University of California at Berkeley recommended consolidating funding resources by linking the federal and state programs currently administered through separate entities.[79] And the executive director of the Tax Credit Allocation Committee told the Commission that if the State were to start over today to develop a statewide housing program, it should put it under one roof.[80]

State officials contend that coordination is difficult because of the different functions, missions and requirements of the agencies. TCAC, for example, operates under federal requirements for project monitoring, while the others do not.

The agencies and programs are funded differently. And with the exception of their housing production programs, most of the functions of each agency have little or no relationship to the functions of the others.

But difficulty and inconvenience are inadequate excuses for the slow pace of reforms to date. In spite of criticism from the customers of these agencies and the recommendations of a state task force convened to address these issues, the concerns are much the same as they were in 1995.

The State should heed these calls to further its goals for housing and protect some of its most valuable partners – the developers of low-income housing. The goals of reform should be to ensure that the developers of affordable housing can access state subsidies in an efficient and effective manner in order to hold down costs and accelerate production.

State agencies should eliminate the "red tape" that impedes access to funds, causes delays and increases costs. It should require state agencies to streamline and coordinate their functions in ways that meet the needs of developers and it should provide resources and technical assistance to developers and community organizations to help build affordable housing.

Recommendation 5: The State should enact policies and practices designed to facilitate easy access to affordable housing resources. Specifically, the State should:

- ***Streamline the administration of state programs.*** The Governor and Legislature should direct the Department of Housing and Community Development, California Housing Finance Agency and the Tax Credit Allocation Committee to further coordinate their activities to provide more efficient and effective services to entities that access their programs. The agencies should strive for continuous service improvement and initially consider the following reforms:
  - ✓ A simplified "core" application for housing production programs with attachments, as necessary, for specific programs.
  - ✓ A "lead" agency and single point of contact responsible to coordinate and guide all applicants accessing more than one program.
  - ✓ Alignment of funding cycles.
  - ✓ Accelerated, concurrent and cooperative application review.
  - ✓ Consistent rating criteria.
  - ✓ Coordinated or consolidated compliance monitoring.

- ***Review progress.*** HCD, CHFA and TCAC should annually report to the Governor and Legislature their progress toward improved cooperation, coordination and service delivery. The departments, in consultation with developers and housing advocates, should identify performance indicators to measure progress, including time and resources required to secure funding, access to information and technical assistance, and compliance monitoring requirements.

- ***Establish a clearinghouse.*** The State should establish an affordable housing clearinghouse in the Department of Housing and Community Development to provide "one-stop shopping" and technical assistance. The clearinghouse should:
  - ✓ Maintain an inventory of private and public sources of funding for affordable housing.
  - ✓ Pursue ways to align federal, state, local and private funding sources.
  - ✓ Provide training and technical assistance to help developers more effectively and efficiently secure project funding.
  - ✓ Provide training and technical assistance to local and regional governments on how to align housing and transportation policy and funding.
  - ✓ Assist local communities to develop public-private partnerships.

Conclusion

Left unchecked, the shortage of housing in California will only worsen. California can no longer depend on the vicissitudes of the economy to bring into balance the supply and demand of housing. In recent decades, through good economic times and bad economic times, the housing deficit has steadily increased.

While the Commission is concerned about the increasing shortfall of all types of housing, it focused on the shortage of housing that is affordable to low-income residents. They are the ones hardest hit by the failure to produce adequate supplies of modest homes near jobs.

If housing production trends continue, California is expected to build less than 60 percent of the new housing it needs to accommodate projected population growth through 2020. If this problem persists, the consequences will effect more Californians – through higher housing costs, through longer commutes that diminish the quality of life, and through diminished economic prosperity as businesses locate elsewhere.

California's growing crisis of housing affordability is the result of public policies that have failed to guide responsible decision-making in cities and counties around the state.

Far too much time has been spent debating how housing quotas are determined and whether the numbers are right. Far too little time has been spent ensuring that housing is actually built. In deference to its tradition of "home rule," the State has stood by while local land use planning and development decisions – made project-by-project and community-by-community – have widened the chasm between the need for and the availability of affordable housing.

In this report the Commission issued a clarion call for invigorated state leadership to solve California's escalating lack of affordable housing. It recommended a comprehensive set of public policies and fiscal incentives to create real opportunities for local governments to develop adequate supplies of affordable housing, while balancing that policy priority with legitimate social and environmental concerns.

It made recommendations for ways to reduce the risks associated with affordable housing that drive developers and private capital away from "brownfield" and infill development to safer "greenfield" development that threatens the preservation of agricultural land and open space and the vitality of our downtowns.

Over time, reforms to make more land available, refocus housing policy on production, reduce risks and attract more capital will increase the supply and reduce the cost of all housing.

Until those policies take hold, subsidies for low-income housing will continue to be necessary. To make the best use of subsidies, the Commission called on the State to ensure that they are consistent, reliable and allocated in ways that provide the most value.

Together, these recommendations provide a scheme for solving one of California's most chronic problems. With aggressive state leadership and in the spirit of partnership with communities, the increasing lack of affordable housing can – and must – be solved.

Appendices & Notes

- ✓ ***Public Hearing Witnesses***
- ✓ ***Advisory Committee***
- ✓ ***Subcommittee Meeting with***
- ✓ ***AffordableHousing Developers***
- ✓ ***Notes***

Appendix A

Little Hoover Commission Public Hearing Witnesses

Witnesses Appearing at Little Hoover Commission Affordable Housing Hearing on April 26, 2001

Julie Bornstein, Director
Department of Housing and Community Development

Timothy L. Coyle
Senior Vice President for Government Affairs
California Building Industry Association

Carole Galante, Executive Director
BRIDGE Housing Corporation

John D. Landis, Professor
Department of City and Regional Planning
University of California at Berkeley

Christine Minnehan
Legislative Advocate
Western Center on Law and Poverty

Randy Reinhart, Vice President
American CityVista
Western Region

Jean Ross, Executive Director
California Budget Project

Witnesses Appearing at Little Hoover Commission Affordable Housing Hearing on June 28, 2001

Orson Aguilar
Senior Program Manager
The Greenlining Institute

Mark Buckland, President
The Olson Company

Daniel Carrigg
Legislative Representative
League of California Cities

Tim Frank
Legislative Representative
Sierra Club

Thom Gamble
Executive Vice President
Shea Homes

Donald Gilmore, Executive Director
Community Housing Development Corporation of North Richmond

Sherman Harmer, Vice Chairman
The Olson Company

Ronald M. Kingston, Legislative Advocate
California Association of Realtors

Stephanie Shakofski, Executive Director
California Center for Land Recycling

Edward Tewes, President
California Redevelopment Association

David Thompson, Interim Director
Housing & Community Development Department
City of Richmond

Scott Wetch, Political Director
State Building & Construction Trades

Sunne Wright McPeak, President & CEO
Bay Area Council

Witnesses Appearing at Little Hoover Commission Affordable Housing Hearing on January 24, 2002

Julie Bornstein, Director
Department of Housing and Community Development

Elizabeth Deakin
Associate Professor of City and Regional Planning
University of California at Berkeley

Jane Graf, President
Mercy Housing California

The Honorable Dee Hardison
Mayor, City of Torrance

Christopher Hilbert, Senior Vice President and Director of Acquisitions
National Housing Development Corporation

Sidney Johnston, Executive Director
The Development Fund

Patrick O'Keeffe
Director of Economic Dvelopment & Housing
City of Emeryville

Theresa A. Parker, Executive Director
California Housing Finance Agency

Jeanne Peterson, Executive Director
California Tax Credit Allocation Committee

Brian Smith, Deputy Director
Planning and Modal Programs
Department of Transportation

Tom Stallard, Supervisor
Yolo County

Appendix B

Little Hoover Commission Affordable Housing Advisory Committee

The following people served on the Affordable Housing Advisory Committee. Under the Little Hoover Commission's process, advisory committee members provide expertise and information but do not vote or comment on the final product. The list below reflects the titles and positions of committee members at the time of the advisory committee meetings in 2001.

Orson Aguilar, Senior Program Manager
The Greenlining Institute

Hugh Bower, Chief Consultant
Assembly Housing and Community Development Committee

Mark Buckland, President
The Olson Company

Daniel Carrigg, Legislative Representative
League of California Cities

Timothy L. Coyle
Senior Vice President for Government Affairs
California Building Industry Association

Cathy E. Creswell, Deputy Director
Division of Housing Policy Development
State Department of Housing and Community Development

Greg deGiere, Consultant
Senate Office of Research

Kimberley Dellinger, Legislative Advocate
California Building Industry Association

Janet Falk, Executive Director
California Housing Partnership Corporation

Carole Galante, Executive Director
BRIDGE Housing Corporation

Mark Gomez
Environmental Program Specialist
Environmental Services Division
City of Oakland Public Works

Dick La Vergne, Chief Deputy
California Housing Finance Agency

Bruce Lofgren, Community Development
Bank of America

Christine Minnehan, Legislative Advocate
Western Center on Law and Poverty

Patrick O'Keeffe, Redevelopment Director
City of Emeryville

Theresa A. Parker, Executive Director
California Housing Finance Agency

William Pavao, Deputy Chief
Division of Community Affairs
Department of Housing and Community Development

Jeanne Peterson, Executive Director
California Low Income Housing Tax Credit Allocation Committee

Erin Riches, Policy Analyst
California Budget Project

Jean Ross, Executive Director
California Budget Project

Margaret Schrand
Community Lending Department
Wells Fargo Bank

Mark Stivers, Chief Consultant
Senate Housing Committee

David Thompson, Interim Director
Housing & Community Development Department, City of Richmond

Fran Wagstaff, Executive Director
Mid-Peninsula Housing Coalition

Robert Wiener, Executive Director
California Coalition for Rural Housing

Appendix C

Little Hoover Commission Subcommittee Meeting with Affordable Housing Developers

On August 15, 2001, the Commission's affordable housing subcommittee met in Richmond, California with executives of leading non-profit housing developers and City of Richmond housing officials to explore from their perspective how state financing programs are working and opportunities for improvement. The subcommittee also toured affordable housing developments in Richmond. Participants included:

Al Bonnett, Senior Vice President
Association for Ecumenical Housing

Carol Galante, President and CEO
BRIDGE Housing Corporation

Donald Gilmore, Executive Director
Community Housing Development Corporation of North Richmond

Fran Wagstaff, Executive Director
Mid-Peninsula Housing Coalition

David Thompson, Interim Director
Housing & Community Development Department
City of Richmond

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