SENATE COMMITTEE ON HOUSING
Senator Scott Wiener, Chair
2021 - 2022 Regular

Bill No:	AB 1850	**Hearing Date:**	6/21/2022
Author:	Ward		
Version:	6/6/2022		
Urgency:	No	**Fiscal:**	No
Consultant:	Mehgie Tabar		

SUBJECT: Public housing: unrestricted multifamily housing

DIGEST: This bill prohibits a city, county, or joint powers authority (JPA) from acquiring unrestricted, multifamily housing unless each unit in the development meets certain criteria.

ANALYSIS:

Existing law:

1) The California Constitution provides that property owned by the State or property owned by a local government, except as otherwise specified, are exempt from property taxation.

2) Authorizes, under the Joint Exercise of Powers Act, two or more public agencies (*i.e.*, federal government, any state, any state department or agency, county, county board of education, county superintendent of schools, city, public corporation, public district, and regional transportation commission in any state) to enter into a JPA to exercise jointly any power common to the contracting agencies that it can do by itself.

3) Defines "public agency" to include, but not be limited to, the federal government or any federal department or agency, this state, another state or any state department or agency, a county, county board of education, county superintendent of schools, city, public corporation, public district, regional transportation commission of this state or another state, or any JPA formed by any of these agencies, as specified.

This bill:

1) Prohibits a city, county, or joint powers authority (JPA) from acquiring unrestricted, multifamily housing unless the development meets the following criteria:

Unit Requirements and Eligibility

a) The unit is subject to a long-term recorded regulatory agreement with a city, county, or JPA that requires the unit to be affordable to and occupied by low- or moderate- income households for a term of 55 years.
b) Existing households whose income at the time of acquisition exceeds the income limit for moderate-income are allowed to remain in residency and rent at market rents until the unit turns over.
c) The unit is in decent, safe, and sanitary condition at the time of occupancy and following conversion.
d) The unit was not acquired by eminent domain.
e) Priority is given in the leasing of units to applicants with housing choice vouchers.
f) Complies with the standards and procedures for basic applicant and tenant rights, including good cause eviction, tenant selection, and leases, as specified.

Rental Rates

g) Rent limits for these projects are consistent with rent limits published by the California Tax Credit allocation Committee (TCAC). For any income levels not published by TCAC, the rent limit shall be based on affordable housing cost for a household at 100% of the area median income (AMI);
h) The initial rental rate and subsequent rental rates comply with the following:

    i. The aggregate initial monthly rents for all units postconversion are at least 10% less than the average aggregate monthly rent charged for all units over the 12-month period prior to conversion, as specified.
    ii. The initial rents for at least 50% of the units are at least 20% less than the small area fair market rent (SAFMR), as specified.
    iii. Increases to the initial rents postconversion are limited per year to the lesser of the annual increase in the AMI for the county, or 3%.
    iv. A project owner may shift rent restrictions on units within a given property so long as the overall distribution of regulated rents remain the same.
    v. All rent limits include an allowance for utilities consistent with TCAC.

Public Entity's Role and Responsibilities

i) The public entity, if not a city or county, contracts with the city, county, or state housing entity to monitor the property for compliance with the regulatory agreement for the term of the regulatory agreement, consistent with the monitoring standards and protocols of TCAC.

j) The first year net operating income is adequate to repay all debt, except public soft debt, amortized on a level debt service basis over a period not to exceed 40 years, as specified.

k) A public entity approves all debt on the property and holds an assignable right to purchase the development, any interest in the development, or any interest in a partnership that owns the development for a price that does not exceed the principal amount of outstanding indebtedness secured by the building.

l) No public entity levies a fee or other charge to the development, except as specified.

m) Compensation to third-party project administrators does not exceed, as specified:

   i. A fee at the time of acquisition no greater than 1% of the acquisition price or $2,500,000, whichever is less.
   ii. An annual fee no greater than $100,000.
   iii. Payments from one or more subordinate cash flow bonds that in aggregate shall not exceed 2% of the acquisition price or $5,000,000, whichever is less.

n) A third-party project administrator is required to reimburse tenants for overpayments and is subject to a penalty of $15,000 per unit for any year in which the rents charged are not in compliance with the regulatory agreement.

o) The public entity and city in which the property is located, or the county for a property in an unincorporated area, agree to utilize all annual cash flow, sale proceeds, and penalty payments solely for one of the following purposes:

   i. The development of housing affordable to and occupied by lower-income persons and families
   ii. To distribute to all property taxing entities in proportion to each entity's share of property taxes that would apply to the parcel or parcels if the property were subject to taxation.

p) The public entity agrees to make public on its website all financial and monitoring reports, as specified.

2) States that these requirements do not apply to a development in the following cases:

   a) When a development is subject to a TCAC or the Department of Housing and Community Development (HCD) regulatory agreement.
   b) When a public entity purchases unrestricted multifamily housing and has determined that the property faces related environmental hazards such as flooding, emergent groundwater, or liquefaction, and the public entity removes the existing structure from the housing market.

COMMENTS:

1) *Author's statement.* According to the author, "By teaming up with public joint powers authorities, private for-profit interests have found a way to avoid paying property taxes on apartment developments. These transactions do not provide public benefit commensurate with the lost tax revenue, are inherently risky ventures at high risk of default, and payout exorbitant fees to the investors. AB 1850 sets minimum standards of ownership for when public entities acquire middle-income housing to ensure that future transactions are equitable for tenants, the local jurisdiction, and other local governments who lose property tax revenues."

2) *Background: JPAs.* The Joint Exercise of Powers Act allows two or more cities or counties to form a JPA for a variety of purposes, including issuing bonds to pay for public projects. To pay for infrastructure such as airports and public hospitals, JPAs issue government bonds. Several JPAs in the state fund affordable housing projects by issuing private activity bonds (PABs), which are required to pair with 4% federal low-income housing tax credits and government bonds. The Federal government caps the amount of PABs a state can issue, but no volume cap exists for tax-exempt government bonds issued by JPAs. JPAs outsource their bond issuance to private financiers or private administrators.

3) *New model for middle-income housing.* In addition to traditional bonding approaches, JPAs have recently begun to partner with private entities to purchase existing multi-family housing. One of the biggest challenges to increasing the supply of affordable housing is the shortage of available public subsidies, and this new model has enabled developers to acquire and preserve units affordable to middle-income households.

   According to recent reports, since 2019, over 40 JPA acquisition deals totaling nearly 14,000 units have been approved in California. The process works as follows:

a) A private entity identifies a property, places a deposit on the property and then approaches a JPA about purchasing the property;
b) The JPA issues government bonds and purchases the property. JPAs outsource their bond issuance to private financiers or private administrators. Unlike PABs, government bonds issued by JPAs are not subject to the state's municipal bond volume cap; and
c) The private entity that initially approached the JPA about buying the property acts as project administrator and asset manager. Because a JPA, a governmental entity, owns the property, it is not subject to property taxes.

Despite the exciting possibilities this new tool could create for middle-income housing, cities and stakeholders have raised major concerns. There are examples of cities not proceeding with JPA-sponsored acquisitions, citing concerns about whether the affordability levels would be commensurate with the forgone property tax revenue.

4) *Housing affordability*. All public funding for affordable housing requires affordability covenants be recorded on developments to restrict the rents to an affordable amount for a specified amount of time, usually 55 years. Affordable multi-family rental housing, the majority of housing financed through public funding, is eligible for households that make 80% of the AMI or less. Public agencies that administer these funds – HCD, the California Housing Finance Agency (CalHFA), or TCAC – monitor the affordability covenants to ensure units remain affordable. In addition to restricting occupancy based on household income, residents are only required to pay 30% of their income toward housing costs, including utilities.

   Housing is defined as "affordable" when a household pays 30% of their income to housing costs. HCD, TCAC, and CalHFA use fair market rents (FMR) established by the Department of Housing and Urban Development (HUD) to determine the rental rates for affordable housing developments. FMR are determined by HUD each year and based on the median rents in the county. HUD's small area fair market rent (SAFMR) are calculated by zip code.

   Unlike traditional affordable housing financing, when JPAs purchase unrestricted, multi-family housing, as described above, the project administrators are not required to record regulatory agreements with affordability requirements but rather must make their best effort to reach target levels of affordability. According to media reports, one-third of households in these developments are 80% AMI or below. The remainder of the units are reserved for households making up to 120% AMI, which is market-rate in some areas. In unrestricted multifamily housing, rents are set based on comparable

market rents. Because these properties are Class A luxury apartments the initial rents are higher than FMRs and may in some cases be market rents.

The terms of the bonds allow project administrators to increase rents by 4% each year. In addition, the rent on units is restricted 30 to 35% of the individual's or family's income – a shift from the standard 30% used in federal, state, and local funding programs.

The unrestricted, multi-family housing created through these JPAs provide a guaranteed middle-income rental unit at the expense of collecting property taxes, but the policy question is: should public resources, in this case a property tax exemption, be used for this purpose when the need for low-income and very-low income units is so dire? Given the housing crisis in California, it is essential to use all available tools to provide affordable housing, but the lack of resources to develop that housing has always been a challenge.

5) *Property taxes.* Cities collect property taxes from market rate housing, both rental and ownership, and distribute a portion of those taxes to the other taxing entities – counties, special districts, and schools. The California Constitution authorizes a welfare exemption from property taxes if a property is used for a charitable purpose. A "charitable purpose" includes units in an affordable housing developments that are offered for 80% AMI or less. The property tax savings from the welfare exemption is intended to reduce the overall cost of the units and to be passed on to lower income households as rent savings.

   The California Constitution also authorizes an exemption from property taxes for government-owned property. The purpose of exempting buildings owned by governments from property taxes is to reduce the overall cost of using the building – for example, if the bonds are used to build a library or a public hospital that is not producing income.

   Unrestricted, multifamily housing owned by JPAs via the purchasing scheme outlined above are exempt from paying property taxes, because the property is owned by a public entity. The exemption applies not just to units that are 80% or below but those that are up to 120% of AMI, which in some areas of the state is market rate rent.

6) *Long-term affordability and a city's responsibility.* The JPA owns the property but the administrator maintains the asset. Cities participate in these models by entering into a Public Benefit Agreement, in which they have no initial ownership in any project. However, the bond agreement gives a city an option to force a sale or refinance the project after 15 years. Once all debt is discharged (after 30 years), a city is the beneficiary of all cash flow from the project or of all net sales proceeds if the project is sold. However, until a sale is

forced or the debt is discharged, cities do not have a fee interest in the project and are not a direct party to the real estate or financial transactions.

Many of these properties are heavily leveraged and in some cases the debt is 120% loan-to-value because of the high purchase price. Investors are relying upon the California real estate market to continue a high rate of appreciation in the coming years. If this does not occur then when cities acquire these properties they may have to sell them, at which point the property is lost as a potential affordable housing option.

7) *Fees*. One critique of this model is the fees charged by project administrators. Administrators charge three fees: (a) the upfront fees to find the property, (b) the cost of asset management, and (c) a fee for servicing the bonds. LITHC caps asset management fees for affordable housing projects at 2.5%. No cap exists for unrestricted multifamily properties and in some cases; administrators are making considerable sums off the fees.

8) *Purpose of this bill*. To address some of the issues raised above and ensure properties purchased under this scheme provide a public benefit beyond just a 4% rent cap, this bill requires an affordability covenant of 55 years and ongoing government monitoring to ensure compliance. The bill also ties the initial and subsequent rent to HUD SAFMRs. To ensure long-term affordability the income on the property must be adequate to repay all debt over 40 years.

9) *Opposition.* Catalyst, a project administrator to two JPAs, writes in opposition to express concern over the bill, "As currently written, AB 1850 imposes unnecessary limitations as to how public entities may purchase rental housing – limitations that would have invalidated every JPA transaction to date." Catalyst goes on to provide a number of responses to the latest bill amendments, primarily focused on the rent restrictions, net operating income requirements, and regulatory agreements. Waterford, another owner and developer utilizing this moderate-income model, also writes in opposition stating, "AB 1850, in its current form, imposes onerous underwriting criteria which makes all JPA 'moderate' income housing projects unfinanceable. In addition to JPA's, local governments and project sponsors, bond investors are key stakeholder in these transactions. If unnecessary regulation is adopted there will be no market to buy these bonds and the program will cease to exist."

   The Housing Endowment and Regional Trust of San Mateo County ("HEART") writes in opposition, unless amended because "AB 1850's well-intended but unprecedented requirements risk rendering any similar financing model unworkable…" including a model that HEART just received board-approval for, but that would not be compatible with the provisions of this bill.

10) *Future author amendments*. The author and sponsors have indicated that the intent of this bill is not to make this funding scheme unworkable, but to create guardrails to create more affordability in line with existing public policy goals. The author and sponsors have received feedback from a wide variety of stakeholders and have worked to further refine those guardrails with that feedback in mind. Given timing, the author intends to submit amendments before the bill reaches the next committee, as follows:

a) Alter the aggregate rent reduction to: 1) look back only 6 months rather than 12; 2) give the owner 12 months to implement the new rents as leases expire; 3) clarify a number of calculation issues that arise relating to vacant units, renovated units, and short-term rent concessions.
b) Replace the requirement that half of units be at least 20% below SAFMR with a requirement that a third of units be rent at the lesser of 80% AMI or SAFMR.
c) Rely on AMI growth as the only cap on future rent increases.
d) Allow the JPA to monitor compliance with the regulatory agreement but require use of TCAC standards.
e) Eliminate the specific underwriting requirements but expresses the intent of the Legislature in future legislation to empower a state housing agency to set underwriting standards.
f) Require replacement reserves that average $500 per unit per year over the term of the financing.
g) Calculate compensation caps on the acquisition price plus rehabilitation costs, raise annual fee caps for both JPAs and project administrators, and create an exemption to the B bond caps.
h) Clarify that the public entity fee caps do not apply to general city or county fees applied to all developments.
i) Allow cities and counties to use proceeds for tenant protection programs, in addition to affordable housing development.
j) Require reporting on units occupied by voucher holders.
k) Require JPAs to have a policy against multiple purchase offers for the same property.
l) Exempt from the bill permanent supportive housing with an average affordability of 40% AMI or less.
m) Broaden the exemption for properties that will be removed from the housing market.
n) Add intent language relating to future legislation relating to direct state oversight and additional standards.

11) *Double-referral*. This bill is double-referred to the Governance and Finance Committee.

RELATED LEGISLATION:

AB 2170 (Mullin, Chapter 386, Statutes of 2014) — specified that the common powers that public agencies may jointly exercise pursuant to a joint powers agreement include the authority to levy a fee, assessment, or a tax.

FISCAL EFFECT: Appropriation: No Fiscal Com.: No Local: No

POSITIONS: (Communicated to the committee before noon on Wednesday, June 15, 2022.)

SUPPORT:

California Housing Partnership Corporation (Co-Sponsor)
San Diego Housing Federation (Co-Sponsor)
California Democratic Party Renters Council
City of San Jose
CSG Advisors
East Bay Housing Organizations
Ensuring Opportunity Campaign to End Poverty in Contra Costa County
Housing California
Housing Now! CA
Inland Equity Community Land Trusts
Merritt Community Capital Corporation
Mi Familia Vota
Non-profit Housing Association of Northern California (NPH)
The People's Resource Center
The San Joaquin Valley Housing Collaborative

OPPOSITION:

California Apartment Association
California Municipal Finance Authority
Californians for Essential Housing
Catalyst Housing Group
Housing Endownment and Regional Trust of San Mateo County (HEART)
Opportunity Housing Group
Waterford Property Company
1 Individual

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