ECONorthwest
ECONOMICS · FINANCE · PLANNING

DATE: July 21, 2023
TO: Winnie Fong, Estolano Advisors
FROM: Erik Bagwell, Emmanuel Lopez, Amanda Ufheil-Somers, ECONorthwest
SUBJECT: WSCCOG Regional Housing Trust Strategy Considerations

Introduction

On April 20th, 2023, the Westside Cities Council of Governments (WSCCOG) Board of Directors unanimously approved the continuation of the study to implement a Regional Housing Trust Fund (RHTF). The Phase 2 implementation work is anticipated to be funded through the second round of the state Regional Early Action Planning (REAP 2.0) grant and is estimated to begin in the Summer of 2023.

The Phase 1 study explored the feasibility of implementing a RHTF. We evaluated the affordable housing context to identify the challenges to increase production in the subregion. We compiled a comprehensive dataset of federal, state, and local funding sources that a prospective RHTF could leverage. And we assessed the existing affordable housing funding commitments of each WSCCOG jurisdiction and their ability to provide gap financing to affordable housing projects.

The intention of this technical memo is to highlight the recommendations from our Phase 1 RHTF feasibility analysis and to provide strategic considerations as the WSCCOG moves to implement the RHTF.

Summary of Recommendations

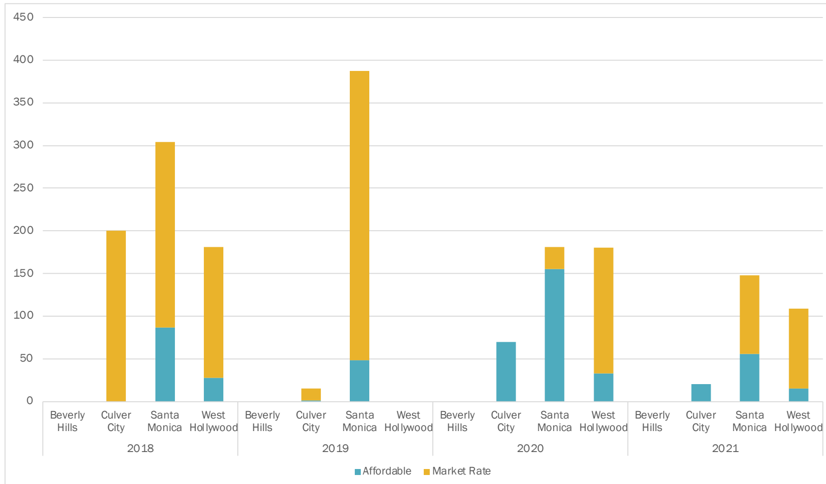
According to permit data collected from the cities of Beverly Hills, Culver City, Santa Monica and West Hollywood, the subregion permitted on average 26 units of affordable housing each year between 2018 and 2021.

The subregion has permitted on average 26 units of affordable housing each year between 2018 and 2021.

Most of market rate and affordable development has occurred in Santa Monica and West Hollywood.

Exhibit 1. WSCCOG Affordable and Market Rate Building Permits 2018-2021

Source: Housing Element Annual Progress Reports



The sixth cycle housing element indicates that subregion needs to produce 9,621 units of affordable housing by 2031.[1] This is equal to the subregion doubling its current rate of affordable housing production each year until 2031. To meet this target the WSCCOG must consider ways to provide gap financing to projects to improve financial feasibility and attract investment to the subregion. The following are our recommendations from this Phase 1 study.

Recommendation #1 - Establish a RHTF to leverage external funding sources and provide technical assistance.

Establishing a RHTF provides a few important tools to increase production. First, existing RHTFs as part of the implementation process through the state legislature were able to obtain state and federal earmarks to capitalize the trust funds. While such earmarks are subject to state economic and fiscal conditions, implementing a RHTF creates the opportunity to for the subregion to request a one-time contribution to kick start the fund.

Second, a RHTF leverages existing funding programs more efficiently. RHTFs are eligible to apply for matching awards as an independent entity and are also able to apply for competitive awards on behalf of member jurisdictions. RHTFs increase efficiency by centralizing the staff capacity required to apply for and manage grants and other matching funding programs.

Third, a centralized location providing technical assistance to projects working with member cities and affordable housing providers will help to shepherd projects from pre-development to certificate of occupancy more quickly. Affordable housing is a complex and process-heavy endeavor. A subregional entity with professional staff that can provide technical assistance for projects by supporting grant applications, financing sources, layer on RHTF proceeds, or issue

[1] The subregion includes just the cities of Beverly Hills, Culver City, Santa Monica, and West Hollywood.

NOFA's for publicly owned land, will help to increase production and attract more developers into the local affordable housing ecosystem.

Recommendation #2 - Work with WSCCOG jurisdictions to secure both one-time and ongoing funding commitments.

To set up a RHTF, the participating jurisdictions must commit resources to leverage matching funds and to support ongoing operations. Member jurisdictions need to dedicate one-time funding commitments and/or dedicate ongoing annual funding. These could come from State or Federal grants or even local contributions. WSCCOG jurisdictions all have local revenue sources that they currently contribute to affordable housing. These include linkage fees, sales and use taxes, inclusionary fees-in-lieu, and general fund dollars. Some portion of these existing revenues could be reallocated to a RHTF. Any funding commitments from jurisdictions should be negotiated as part of the process to establish and capitalize the RHTF, and ongoing funding commitments should attempt to maximize matching grant awards, which usually requires dedicated local sources.

Recommendation #3 – Adopt a subregional affordable housing zoning code that WSCCOG jurisdictions can implement.

A RHTF will not succeed if there are not enough sites available to increase production. Zoning standards and height restrictions across WSCCOG jurisdictions restricts the supply of developable land. Variations in zoning complexity, allowable densities and other requirements complicates a subregional approach to accelerating affordable housing production, especially if the goal is to have an equitable distribution of development across participating jurisdictions. A RHTF will quickly deplete its funding if it must constantly cover the high cost of land—costs that can increase when high-density market rate multifamily or commercial uses are allowed as of right—and affordable housing providers must compete to acquire that land.

Creating an affordable housing zoning code in each WSCCOG jurisdiction that offers both a density bonus for affordable housing projects in low-rise residentially zoned areas and allows affordable housing in low-density commercial or light-industrial areas not currently zoned for residential as a by-right use could free up more land for affordable housing production. This would only allow affordable residential development up to typical densities of four or five stories and give priority access to jurisdictions and affordable housing providers to acquire land at more affordable rates. This could reduce the land acquisition costs and subsequently the gap financing needed from a RHTF to make affordable housing development feasible. Many of the WSCCOG jurisdictions are already taking steps to revise their code to allow for more density and taller buildings but more work is needed to ensure that there are enough sites to meet the subregions production targets.

Recommendation #4 – Determine fund design and management structure.

There are different ways that a RHTF could be designed and managed. As part of the process to formalize the trust, WSCCOG and partner jurisdictions will need to determine and draft the following:

- Bylaws
- Board Structure
- Policies and procedures.
- Management entity
- Lending and project priorities

The next sections of this memo will detail some of the strategic considerations that the WSCCOG should consider as it begins to implement a RHTF.

Strategic Considerations

Formation and Governance

Joint Powers Authority

The Joint Exercise of Powers Act in California authorizes two or more public agencies, by agreement, to form a Joint Powers Authority (JPA). The formation of a new JPA enables the creation of a separate government entity established by member public agencies but is legally independent from them. In the case of a RHTF, a JPA is needed to form the trust to receive available public and private funds, authorize and issue bonds or other debt instruments, and facilitate and create lending and grant programs to increase the production of affordable housing.

Formation Legislation

Although legislation is not required to form an RHTF, many COGs have formed them through the legislative process to obtain state or federal earmarks. The San Gabriel Valley COG, Orange County, and Burbank/Glendale/Pasadena have all formed their RHTFs via legislation. To form the RHTF in this manner, the WSCCOG would need to work with its local state legislators to introduce language, via a spot bill or through an amendment to another proposed regional housing trust bill. The WSCCOG and participating jurisdictions would then submit a request for state funding through state representatives championing the legislation and, ideally, obtain seed money to capitalize the RHTF through the budget process. Between introduction of the legislation and the Governor's signature, the Legislative Committee and WSCCOG Legal Counsel would draft JPA documents, bylaws, and other administrative procedures needed to form the RHTF.

Membership

While a prospective RHTF may be implemented by the WSCCOG, there is no requirement that all participating WSCCOG jurisdictions participate in the RHTF. Jurisdictions that do not participate in the formation of the RHTF at the outset could join later but will forgo the opportunity to take part in the creation of initial policies such as determining the size and source of administrative fees to fund operations, project selection criteria, board structure, and management approach. Such policies as well as the bylaws may be amended by the RHTF board of directors in the future but jurisdictions that participate during the implementation phase are more likely to influence the process and policies and set the strategic priorities of the trust.

Regional Housing Needs Allocation (RHNA) Credit

An existing challenge to subregional approaches to affordable housing development is that currently the California Department of Housing and Community Development (HCD) only credits RHNA units to jurisdictions where a project is permitted and developed. This is partly because RHTFs are a newer innovation. However, as more COGs and subregions form RHTFs, HCD will likely need to reconsider its policy to credit RHNA units more holistically. In the meantime, the best way to ensure that the RHTF can support affordable housing development equitably across the WSCCOG jurisdictions and receive RHNA credit is to help affordable housing providers secure land and ensure that each city's zoning code allows for adequate development capacity to enable financially viable projects that can compete for competitive sources of funding.

Priorities and Partnerships

As part of this Phase 1 study, we found that the equitable distribution of affordable housing development in the subregion is important to meet regional housing production goals. We also found that the price and competition for developable land for affordable housing in the subregion is a very limiting factor to increasing production.[2] We found that if land is free, most 9% Low Income Housing Tax Credit (LIHTC) projects require modest amounts of gap financing to be financially viable. However, including the cost to acquire land at market prices can create a financing gap of several million dollars to a given project in the subregion. Below are some considerations to address both the challenges of land and the equitable distribution of projects.

Inventory Opportunity Sites

LIHTCs and other funding sources such as Affordable Housing and Sustainable Communities (AHSC) program in California are competitive. The Tax Credit Allocation Committee (TCAC) and HCD score applications based on a variety of criteria ranging from proximity to amenities such as grocery stores, libraries, schools and transit to green building elements and onsite services such as childcare and after-school programming. The WSCCOG should work with its partner jurisdictions to create an inventory of affordable housing opportunity sites owned by the jurisdictions, other public agencies, and private owners based on how well they score for a variety of affordable housing related funding sources. The jurisdictions should then consider rezoning those sites should local zoning code limit the redevelopment potential. The RHTF would then solicit available public sites for redevelopment and work with development partners to support land acquisitions of the identified privately owned opportunity sites. This inventory could also identify opportunities to assemble larger sites by combining public and private parcels.

---

[2] See ECONorthwest's Pro Forma and Housing Financing Mechanism Analyses memo for details of the analysis and a summary of findings.

Revolving Loan Fund

To support affordable housing developers in pre-development and provide financing for land or building acquisition, many jurisdictions have put into the place Revolving Loan Funds (RLFs). Typically, RLFs are designed to provide pre-development loans (i.e., early-stage loans that make it easier for affordable housing providers to overcome initial obstacles while they finalize a project and secure permanent financing). Loan proceeds are usually used for land acquisition, professional service expenses (design, engineering, and legal), construction loans, bridge loans, rehabilitation expenses, and mini permanent loans. Loans provided by a RLF would typically be structured as short-term, below-market loans to be repaid from construction or permanent financing. Once repaid, the loans and their accrued interest will revolve back into the RLF and can be lent to other prospective projects.

Including a RLF as part of the RHTF strategy, will help preserve capital, provide a flexible source of below-market rate financing to help compete for opportunity sites, and potentially attract other lending partners and affordable housing developers into the WSCCOG affordable housing ecosystem.

Equity Considerations

Beyond supporting land acquisition, once implemented the RHTF will need to determine its funding priorities and criteria for funding awards. As part of this Phase I project, we heard the desire from the COG to achieve an equitable distribution of projects across the partner jurisdictions. While we recommend changes to zoning—as discussed in the Summary of Recommendations section under Recommendation #3—to support the equitable distribution of development opportunities, the RHTF should also consider equity as a criterion for its funding awards, considering members' housing needs and distribution of past funding awards. The RHTF should also consider affordability levels, populations served, and cost effectiveness when determining funding priorities. For example, the RHTF may choose to prioritize addressing chronic homelessness as a goal of the RHTF through the production of more units of Permanent Supportive Housing (PSH). Therefore, projects proposing deeper affordability and on-site or off-site services may be score higher for funding awards.

However, such priorities may come with tradeoffs. Projects prioritizing deeper affordability and addressing homelessness may also be less cost-effective. Lower income projects cannot leverage as much private financing since rents are lower and certain funding sources may trigger prevailing wage, which makes development more expensive. The RHTF and its board will need to carefully consider these tradeoffs across projects as it seeks to increase production while trying to yield as many affordable units as possible to meet RHNA targets.

Funding Sources and Lending

Capitalization

The initial capitalization of the RHTF is critical to determine the scale and velocity of affordable housing projects that it can finance annually. As discussed in the Formation and Governance section under Formation Legislation, establishing the RHTF via a JPA and state legislation offers the opportunity to obtain a state or federal earmark for seed money to capitalize the RHTF. Receiving such an allocation will depend on the fiscal conditions of the state and federal governments and finding a local state representative to champion the bill and advocate for funding. If there are clear challenges to receiving a state or federal allocation, then the RHTF and the partner jurisdictions will need to rely on leveraging the state, regional, and local affordable housing funding programs to capitalize the fund.

Leverage and Local Commitments

The primary benefit of a RHTF is the opportunity to pool funds to leverage matching awards from state and federal affordable housing funding programs. Annually, programs like the state Local Housing Trust Fund (LHTF), the Permanent Local Housing Allocation (PLHA), and the federal Home Investment Partnerships Program (HOME) provide matching grants to cities, counties, and housing trust funds to use to provide below-market financing to affordable housing projects. To capitalize the fund in the absence of a state or federal budget allocation, the RHTF and its partner jurisdictions will need to make both one-time and ongoing funding commitments. As part of the implementation process, the number of one-time commitments should be sized on the estimated number of units that the RHTF intends to finance each year.

The actual revenues for one-time commitments could come from a variety of sources such as dedicated federal housing funds received through the Community Development Block Grant (CDBG), HOME, and other U.S. Housing and Urban Development (HUD) programs. As an entitlement city, Santa Monica receives formula allocations of these funds each year directly from HUD. Beverly Hills, Culver City, and West Hollywood receive subgrants by agreement from Los Angeles County's formula allocation. Additionally, the RHTF will need to secure ongoing revenues dedicated to the RHTF from participating jurisdictions. These commitments should attempt to maximize the matching grant awards of LHTF, PLHA and other matching funding programs. Our research suggests that to maximize LHTF and PLHA awards equal to $10 million, four participating jurisdictions would each need to contribute $1.25 million annually. Achieving any local commitments to the RHTF from participating jurisdictions will need to be negotiated during the early phases of implementation.

Underwriting Standards

Once a RHTF is capitalized it then needs to evaluate projects to support financially. Establishing underwriting standards will help to make lending transparent to developers while at the same time limiting any undue enrichment to projects. Setting these standards typically includes determining the type of loans it is willing to provide (i.e., construction, bridge, or permanent loans), the term (i.e., 5 ,15 or 30 years), and the structure (i.e., interest only or amortizing). In general, prioritizing shorter payback periods will recapitalize the fund more quickly to then lend out to other projects. The RHTF will also want to set maximum loan amounts, its loan to value ratios, interest rates on its debt based on each project's ability to pay debt service, developer fee guidelines, a debt service coverage ratio minimum, maximum operating expenses, and reserve requirements for any projects that it lends to.

Technical Assistance

An important benefit of a regional fund is the opportunity to provide technical assistance to both jurisdictions and affordable housing providers. While most city governments apply for state and federal grants, some jurisdictions within the WSCCOG may lack staff capacity or technical expertise to maximize state and federal funding sources or provide specific technical support to prospective projects in their jurisdictions. Such constraints limit production. Similarly, many affordable housing providers are small nonprofits who are mission driven who may have capacity challenges of their own. A RHTF can take over the duties of applying for and managing affordable housing grants and other revenues, which would free up staff capacity at partner jurisdictions to focus their efforts on other specific housing and land use matters. An RHTF can also support developers who have proposed projects in the RHTF's pipeline with applying for and layering project-specific funding sources that may be unfamiliar to affordable housing providers. The availability of this kind of technical assistance is critical to increasing production to meet each jurisdiction's affordable housing RHNA targets.

RHTF Management and Operations

There are a couple common approaches in California to managing the day-to-day operations of a RHTF. Typically, RHTFs have either created a separate entity that contracts with the COG or with a third-party contractor that is often either a Community Development Financial Institution (CDFI) or other consulting firm with technical expertise and experience in managing fund operations. Choosing the optimal approach can depend on a few factors such as the primary activities of the trust fund and the level of involvement the COG wishes to have within the operations of the trust. For example, a RHTF that functions as a RLF focused on predevelopment will likely want additional capital partners involved such as the Corporation for Supportive Housing (CSH) or the Low-Income Investment Fund (LIIF), who often underwrite the loans for pre-development and acquisition loans for affordable housing projects. In this case, a third-party contractor with these kinds of relationships may be best suited for setting up the fund and managing operations.

For a RHTF that is offering more technical assistance across a variety of projects and providing different types of loans and support, having dedicated in-house staff contracted with the COG may be advantageous. Flexibility in project support and leveraging various funding sources is better suited for a RHTF that is seeking to increase production through addressing different project financing needs at different stages.