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Council Districts: Citywide  
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Honorable Members of the City Council  
City of Los Angeles  
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**COUNCIL TRANSMITTAL: REPORT BACK FROM THE LOS ANGELES HOUSING DEPARTMENT REGARDING FEASIBILITY OF THE CITY AUTHORIZING THE ISSUANCE OF TAX-EXEMPT BONDS FOR THE PRODUCTION, PRESERVATION, AND PROTECTION OF MIDDLE-INCOME RENTAL HOUSING**

**SUMMARY**

The General Manager of the Los Angeles Housing Department (LAHD) respectfully submits this report in response to C.F. No. 20-1598. The referenced Council action requested that LAHD, the City Administrative Officer (CAO), Chief Legislative Analyst (CLA), and City Attorney to report back on the feasibility of the City authorizing the issuance of tax-exempt bonds for the production, preservation, and protection of middle-income rental housing.

**RECOMMENDATIONS**

That the City Council receive and file this report.

**BACKGROUND**

At a regular meeting held on January 27, 2021 the Housing Committee virtually considered a Motion (Blumenfield - Price) relative to a report on the feasibility of the City becoming a member of the California Statewide Communities Development Authority (CSCDA), a joint powers authority created to enable local government access to low-cost, tax-exempt financing for projects that provide public relief, contribute to social and economic growth and improve the overall quality of life in communities. After providing an opportunity for

public comment, the Committee amended the recommendation in the Motion and approved as amended and indicated in the “Summary” section above.

In preparation for this report, LAHD conducted research on similar proposals for middle-income/workforce rental housing programs that were considered in other major cities like Long Beach and San Jose. LAHD also examined any current City, state and federal policies that needed to be considered for this report. This report outlines LAHD's findings based on the information gathered, published articles, and communications to LAHD. Some of these findings are limited to information that was available online or directly from cities that were willing to respond to our inquiry regarding their middle-income rental housing programs.

## **FEASIBILITY**

### ***Program Structure***

Middle-income or workforce housing programs, as commonly implemented, are designed to acquire properties for individuals and families earning between 80% to 120% Area Median Income (AMI). Housing developments serving this population are not eligible for state-level tax credits, private activity bonds, or most other federal, state, or local government subsidies, unlike those developed for low to very low-income individuals/families. It is worth noting that with the passage of United to House LA, the City now has a source to help finance multifamily housing with a broader range of incomes, including 80% to 120% AMI.

Joint Powers Authorities (JPAs) issue and manage bonds on behalf of local governments that join as members. In order to address the middle income housing bracket, more specifically, those earning between 80%-120% AMI, the JPAs acquire new or existing multifamily housing properties using tax-exempt government bonds to help fund housing development, while restricting rents, rent increases, and occupancy for residents within the middle-income bracket through regulatory agreements. Rent increases for qualified renters can be capped at no more than 4% annually. Since these entities include a government authority, in this case, the City of Los Angeles, as a member, the exemption from property tax would be passed along to tenants in the form of lower rent.

The three most known JPAs in California involved in these programs are California Statewide Communities Development Authority (CSCDA), California Community Housing Agency (CalCHA), California Municipal Finance Authority (CMFA). These JPAs issue bonds and use the proceeds to purchase properties, and pay private companies that arrange the financing and management of the buildings. The success of JPAs is dependent upon what has been a tremendous appetite for investors of “high-yield” unrated bonds issued by JPAs. The bond's trading price has been akin to A-rated securities, even though they are unrated. As interest rates increase, the appetite for these bonds has decreased, slowing investor appetite for tax exempt municipal bond funds.

The JPA finance structure is reliant on two sets of bonds: The Essential Housing Revenue Bonds – Bond A, which is used for the actual purchase of the property; and the “B Bond”, to pay property managers and other parties and fees. The bonds mature in approximately 30 years. Once they are paid off, the local jurisdiction can direct the sale of a property with no debt, or manage the property on an ongoing basis and take out a loan to maintain the building. It should be acknowledged that the loss of property tax revenue will affect not only the local jurisdiction involved

in the JPA, but also the local school district and the County. The proponents for this program emphasize that rent savings to tenants offset the loss of revenue to the local jurisdiction and that appreciation of the subject property over the life of the bonds and related regulatory agreement can provide a substantial return to the local jurisdiction over and beyond the loss in property tax revenue over a period of time. Under a Public Benefit Agreement, the local jurisdiction, County, and school district could receive all surplus revenue when a property is sold or refinanced. Opponents of the program counter that property appreciation at the time of sale is speculative and the property may likely need substantial renovations. Moreover, if rental income has not increased as projected, there may be limited surplus revenue available to satisfy partners of the Public Benefit Agreement.

The developers or sponsors of these projects cannot be owners of the properties involved. They are paid through a fee-based arrangement and take an asset management position during the period of time that the middle income covenant is in place. Only the bond issuing entity, CSCDA/CalCHA or CMFA, along with the sponsoring local jurisdiction, are considered the owners of the project.

### ***Cities that have joined JPAs***

Long Beach City Council approved a “pilot” program called Oceanaire, with no other similar projects to be approved until the City Council is provided an opportunity to consider the city manager’s proposed policy. This project converts a 216-unit apartment building that was developed in downtown Long Beach in 2019 to a middle-income rental housing project. This project will benefit the 80-120% AMI population. Affordability is not as beneficial for this project, since only the units restricted at 80% AMI will see significant rent reduction, while the other restricted rents are higher than market-rate. The acquisition of the project will be fully financed by a \$139.4 million tax-exempt Essential Housing Revenue Bond (Series A) issued by the CSCDA as well as a subordinate \$5.0 million (Series B bond) providing preferred equity to the project’s developer, Waterford. Over the first 15 years of the Project, \$20.8 million in fees are charged to the Project to be paid to the developer. Other cities that joined JPAs include West Hollywood, Anaheim, Escondido, Glendale, Carson, and Pasadena.

### ***Cities that have not joined JPAs***

San Jose City Council decided not to join any established programs due to concerns over loss of property tax revenue, lack of city oversight, and how compensation paid to project participants limits affordability to levels it considered “modest”. Their concern is that in the event of substantial losses in property tax revenue, there should be significant public benefit. Affordability options reviewed as part of this determination were as follows:

- 40% units at 80% AMI, 20% units at 100% AMI, 40% units at 120% AMI
- 10% units at 60% AMI, 20% units at 80% AMI, 70% units at 120% AMI

In the hypothetical program analyzed by the City of San Jose, at between years 15 and 30, the local jurisdiction has a right of first refusal to purchase the property for the amount of debt then on the property. If bondholders on either set of bonds foreclose on the property, this right is lost. Therefore, the local jurisdiction also has no control as to how much debt is amassed by the project during its first 15 years. If the local jurisdiction declines to purchase, the JPA, who would have been CSCDA in this case, must sell the property and distribute any net sales

proceeds remaining after paying off any debt. The report indicates that the city had five main concerns which are as follow: (1) no third party exists to oversee ongoing income compliance; (2) compensation is not directly tied to parties' performance or risk taken; (3) transaction fees are high relative to renters' benefits; (4) foregone revenue of property tax and transfer tax revenues could be significant over time, including reducing revenues specifically for affordable housing and homelessness; (5) high purchase offers made possible by local tax subsidies may crowd out private investment, alter submarket property prices, and limit the City's ability to acquire the buildings from JPAs later. The City of San Jose also indicated that these concerns can only be mitigated if additional, sustainable resources – like more funding and additional City staff – are available during the life of the project, which would be 15-30 years in this case. Other cities that also decided not to join any of the JPAs are Oakland, San Mateo, and San Francisco.

### ***Risks***

The main intention of the middle-income housing programs is to serve the so-called “missing middle” who are individuals and families priced out of the real estate market and are also excluded from the more prominent low-income affordable housing programs. The JPA properties rely on a property tax exemption to provide lower rents. This exemption reduces building expenses which in turn allows for reduced rental income. While the local jurisdiction does not award a cash subsidy to help acquire the properties, the ongoing property tax exemption is a significant voluntary tax subsidy by the participating local jurisdiction, and a significant involuntary contribution by the County, local school districts, and other overlapping tax entities, including the State of California (through its funding formula backfilling property tax for school districts). While the local jurisdiction provides the property tax exemption as a financial benefit in lieu of a subsidy, as owner they would still be financially obligated to the project. And if the project deteriorated or failed, the residents living in them would also be adversely affected. As a result, there are certain implied responsibilities, financial and otherwise, that the local jurisdiction assumes for these transactions.

These projects require 100% debt financing with no equity partner contribution and likewise, require certain underwriting assumptions to support that debt. The potential financial benefit that the proponents for such programs tend to present to local jurisdictions is highly sensitive to the rent growth assumptions; and, given uncertainty with the market during, there are likely situations where the local jurisdiction and other taxing bodies would not recover foregone property taxes or make a profit, which would otherwise have been payable to, in the City of Los Angeles' case, the City, Los Angeles Unified School District, and Los Angeles County (i.e., the total rent savings passed through to tenants may not exceed the forgone property taxes plus profit back to the jurisdiction).

The financial structure of these programs are ambiguous on their debt and expenditure plans. One major risk identified is that the debt acquired is serviced through rental revenue and the property itself also serves as security; hence, the property could be sold to satisfy the debt service and thus eliminate any backend upside the local jurisdiction could realize on the subsequent sale of the property. While it is true that the local jurisdiction is not directly liable for the debt, it would join a JPA that would issue non-rated bonds subject to federal securities laws and antifraud provisions; and would be associated with any bonds that fail or encounter difficulties, which could

greatly affect any participating local jurisdiction's credit. It is also worth noting that the developer, who is paid an acquisition-type fee and receives an ongoing monthly or annual fixed payment amount of the income, and the JPA, are both not liable for repayment of the bonds. These developers provide no equity or capital, despite collecting fees that would seem to suggest otherwise.

There seems to be only a limited number of projects that this type of program works for; and they are very large 150+ size projects. Projects of this size trigger compliance with various local requirements, such as the City's Accessible Housing Program (AcHP) to ensure that people with disabilities have an equal opportunity to rent, use. It is unclear to what extent developers consider expenditure to comply with these requirements. Moreover, the financial structure does not demonstrate if it can accommodate major maintenance and renovation costs for these large properties, which most likely would be required after the first ten years of operations, or sooner. Without a long-term capital expenditure plan, there may not be sufficient resources for major renovations that will almost certainly be needed.

There is also the concern over levels of affordability in some local jurisdictions, including over compensation paid to government entities and project managers, which was considered excessive and ate into how much the rents could be reduced. With Los Angeles as a major city in California, affordability is key, and if there is cheaper rent that can be found in the surrounding areas where the programs operate, the program is most likely to raise scrutiny.

Based on an analysis of the information gathered through this report, the department asserts an abundance of risks and costs to the City outweighing benefits of the issuance of these tax-exempt bonds for the middle-income housing development. The product may convey some value to some renters in these buildings and to the City in the long-term; however, with the uncertainty of the program's financial structure, foregoing property tax revenues seems to only provide modest affordability benefits. Fortunately, HACLA pursued this strategy with a single purchase and it may be worthwhile to monitor the performance of their investment before pursuing the strategy through LAHD. It should be noted that HACLA has two advantages to LAHD: HACLA can apply their own vouchers to appropriate units and HACLA has in-house property management capacity.

The City would need to further determine if there is actual benefit and set-up the parameters for involvement; however, with other programs being at the forefront of the Mayor's and City Council's priorities, LAHD recommends not to pursue this type of program at this time, based on current resources, special requirements related to AcHP, and uncertain benefits to the community.

### **FISCAL IMPACT**

There is no impact to the General Fund.

Approved By:

A handwritten signature in cursive script, appearing to read "Ann Sewill".

ANN SEWILL

General Manager

Los Angeles Housing Department