

COMMUNITY INVESTMENTS

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SPECIAL ISSUE ON AFFORDABLE HOUSING

Affordable Housing in High Cost Areas

An Introduction

State Housing Trust Funds

Meeting Local Affordable Housing Needs

Innovations in Housing Policy

The Evolving Role of Local Government

Stuck in the Middle

Financing Workforce Housing

Some Assembly Required

Using Manufactured Housing in Affordable Housing Development

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This publication is produced by the Community Affairs Department of the Federal Reserve Bank of San Francisco. The magazine serves as a forum to discuss issues relevant to community development in the Federal Reserve's 12th District, and to highlight innovative programs and ideas that have the potential to improve the communities in which we work.

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CI Notebook

by Jack Richards

Community Affairs Officer

You may have noticed some changes in *Community Investments* this year. Our first two issues each contained in-depth articles focused solely on a specific topic—our nine-state Environmental Assessments (in January) and Asset Building (in May). We've shifted to this format in part because of the recent addition of an in-house research group that is providing us with the analytic talent to drill into issues, synthesize available data and information, and present findings in what we hope is an accessible manner.

This publication continues the single-topic trend by looking at the issue of affordable housing in high cost areas. Our Environmental Assessments identified affordable housing as a top community development priority in much of the Federal Reserve's 12th District, where many of the country's most expensive and fastest growing real estate markets are creating acute community development challenges. As we seek solutions, we've asked ourselves what the drivers of the affordability crisis in high cost housing markets might be, and what roles various stakeholders should play in addressing the problem.

This issue's introductory article probes these questions and lays the groundwork for a subsequent series of articles which explore potential solutions for creating affordable housing in expensive real estate markets. We look at the various tools used by state and local governments and even private investors to fill the gap left by declining federal dollars, such as housing trust funds and workforce housing funds. We also examine local regulatory initiatives, such as community land trusts and inclusionary zoning, which can be used to promote affordable housing. Also highlighted are some creative techniques being employed to reduce construction or operating costs, including manufactured housing and green design.

We hope you find this information useful in your work and we look forward to finding ways to work together to highlight innovative solutions, leverage available resources, and build new public/private partnerships. We also thank you in advance for helping us to update our mailing list by returning the tear-off postcard on the cover of this issue. As always, please don't hesitate to contact us with your feedback and your ideas for collaboration.

Jack Richards



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Affordable Housing in High Cost Areas

An Introduction

By Carolina Reid

It was the buzz of the weekly neighborhood cocktail party. A house down the street—1,200 square feet, with 2 bedrooms and one bath—sold for just over \$900,000. It was on the market for two days. While the homeowners on our block happily toasted the Bay Area’s red hot housing market (and their growing wealth), the renters among us contemplated our fate with less exuberance. With every record increase in house values, the dream of owning a home slips further away. How is it possible that even with two incomes, we can’t afford to buy a house in a neighborhood with a good elementary school and a safe playground nearby?

Mirrored in the disparate reactions of the homeowners and renters on my block, the recent housing boom is a mixed blessing as far as its impact on community and economic development. On the positive side, the last ten years of rising home values have contributed to broad gains in wealth across a large spectrum of homeowners. Neighborhoods long plagued by abandoned buildings and vacant lots are receiving a facelift in the form of new condos and mixed-use developments, spurred on by the increased demand for housing. Housing also continues to serve as a pivotal driver of economic growth, with housing consumption and investment comprising 22 percent of GDP growth in the first three months of 2005.¹ In addition, the housing boom has translated into much needed jobs. Encompassing

everything from construction workers to land surveyors to loan officers, the real estate industry added 700,000 jobs to the nation’s payrolls since 2001—at the same time the rest of the economy lost nearly 400,000.²

On the negative side, however, the explosion in house values has contributed to a crisis in affordable housing, and a growing number of families nationwide are facing critical housing needs. According to the Joint Center for Housing Studies, nearly one in three households spends more than 30 percent of income on housing, and more than one in eight spends upwards of 50 percent.³ The same study found that the number of low-income households paying more than 50 percent of their income for housing increased by over 1.5 million between 2000 and 2003. Problems with affordability have worked their way up the income ladder, with middle-income families similarly facing high housing costs relative to their incomes (Figures 1.1 and 1.2). Stories abound of firefighters, nurses, and teachers unable to afford to live in the communities where they work. Rising construction and land costs, combined with declines in federal funding, provide a daunting challenge for developers trying to build new affordable units. Concerns are also emerging about the costs of homeownership, particularly as more homeowners take out adjustable rate or risky interest-only mortgages to make ownership possible.⁴

Figure 1.1. Share of Cost-Burdened Households, 2003 (percent)

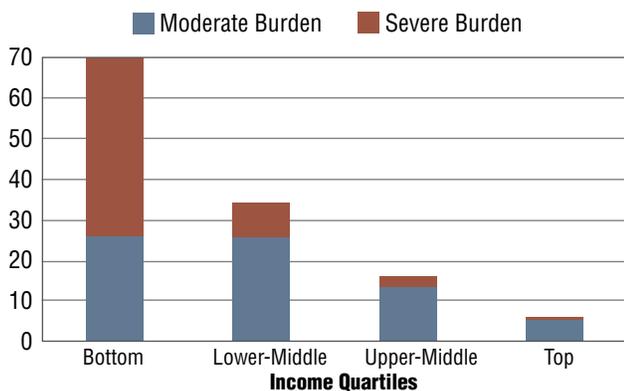
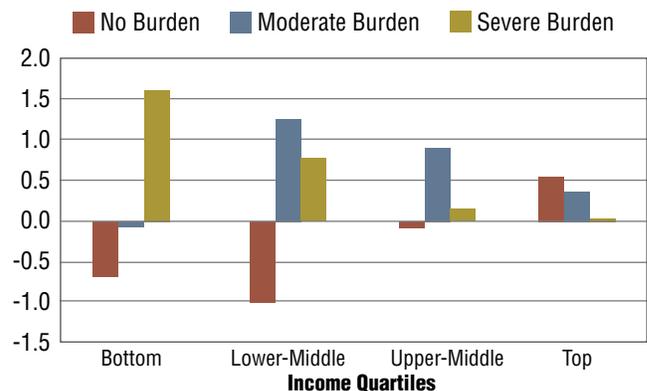


Figure 1.2. Change in Households, 2000-3 (millions)



Notes: Income quartiles are equal fourths of all households sorted by pre-tax income. Severe burden defined as housing costs of more than 50 percent of pre-tax income. Moderate cost burdens defined as housing costs of 30-50 percent of pre-tax income.

Within the Federal Reserve's 12th District, the issue of housing affordability has emerged as a key community development challenge.⁵ The District is home to some of the highest cost housing markets in the nation, and low- and moderate-income families across the region are finding themselves among those with critical housing needs.⁶ In this issue of *Community Investments*, we explore what it means to provide affordable housing in the high cost areas of the 12th District. This article provides a brief overview of the issue of affordable housing in high cost areas, while the rest of the articles explore various approaches to financing and building affordable housing units.

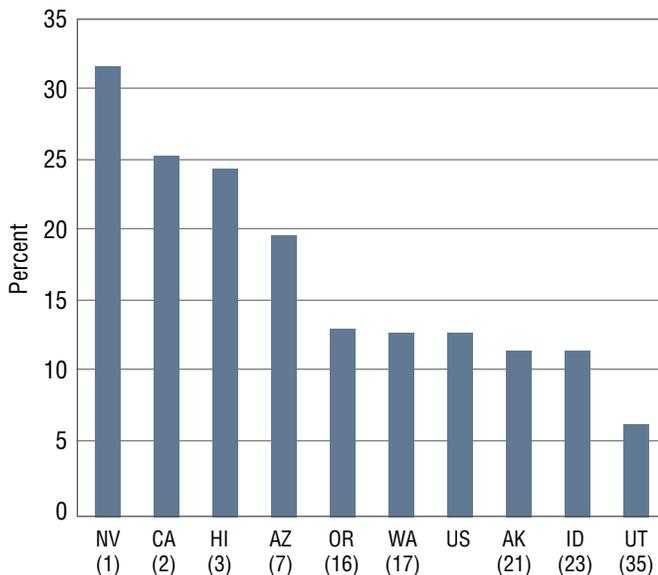
Understanding the Affordable Housing Challenge in the Twelfth District

Nationally, the performance of the residential housing market over the last ten years has been remarkable. According to the Office of Federal Housing Enterprise Oversight (OFHEO), house prices have appreciated nearly 70 percent since 1995.⁷ And to the ire of doomsayers predicting the collapse of the housing bubble, the trend toward higher house prices does not appear to be abating. The most recent statistics show that house values increased 12.5 percent between 2004 and 2005, with regions like the Pacific showing even faster rates of growth (21.3 percent).⁸

Within the 12th District, a number of regional and local housing markets have experienced even higher rates of growth. A recent study by the Center for Housing Policy reported that San Francisco is now the least affordable housing market in the country—no surprise to the thousands of working families in the city trying to make ends meet.⁹

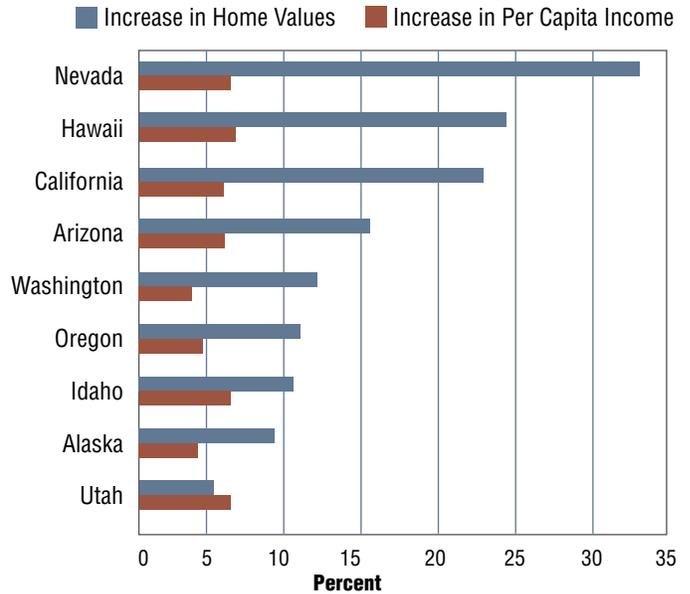
Figure 1.3. Annual Average Home Price Appreciation by State, 2004–2005

(National rank indicated below)



Six of the nine 12th District states have higher home price appreciation rates than the country as a whole.

Figure 1.4. Home Price Appreciation far Outstrips Income Growth



Home prices are growing faster than per capita income in many markets. Utah is the only state in the 12th District in which income growth has exceeded home price growth.

But the problem of high cost housing isn't limited to the Bay Area. At the state level, Nevada, California, Hawaii, Arizona, Oregon, and Washington have all seen house prices rise significantly faster than the country as a whole (Figure 1.3). Nearly half of the 55 metropolitan areas experiencing "boom" housing markets—those with real home prices increasing at an average annual growth rate of ten percent over the past three years—are located in the nine states of the 12th District.¹⁰

Even more striking are the recent statistics from OFHEO, which show that smaller cities in our district, such as Las Vegas, Nevada, and Bakersfield, California, have experienced annual growth rates of over 30 percent, the highest rates of house price appreciation in the country.¹¹ Once limited to large metropolitan areas and hard to reach places like Hawaii and Alaska, high cost areas now include agricultural regions like California's Central Valley and vacation destinations like Palm Springs, Las Vegas, and Sun Valley. Population growth and in-migration, the rising costs of construction (for both materials and labor), historically low interest rates, and speculation in the real estate market are all believed to be contributing to these rapid rates of growth.

One of the consequences of these rapidly escalating house values is that housing affordability is at a 25-year low.¹² In 37 states (including the District of Columbia), home prices are growing faster than per capita income, creating a large gap between what people earn and what they can afford.¹³ In the 12th District, the gap between income and home prices is growing faster than anywhere in the nation, with Nevada heading the list and California, Hawaii, and Arizona all ranking in the top ten (Figure 1.4). Indeed, much of the

job growth has been in low wage, service sector positions, and median incomes fall far below a family's ability to afford a median priced housing unit. Put another way, the real estate boom may be creating construction jobs, but for the construction laborer in Los Angeles earning \$29,050, his income falls more than \$70,000 short of what is needed to qualify for a mortgage on a median priced home.¹⁴ In 49 counties within the 12th District, a two-bedroom apartment rental would only be affordable to families earning the minimum wage if they could hold more than three full-time jobs (Figure 1.5). These sobering statistics likely understate the true magnitude of the affordability problem, as they do not capture the tradeoffs people make, be it living with extended families, commuting long distances, or simply not paying for other necessities like health care.¹⁵

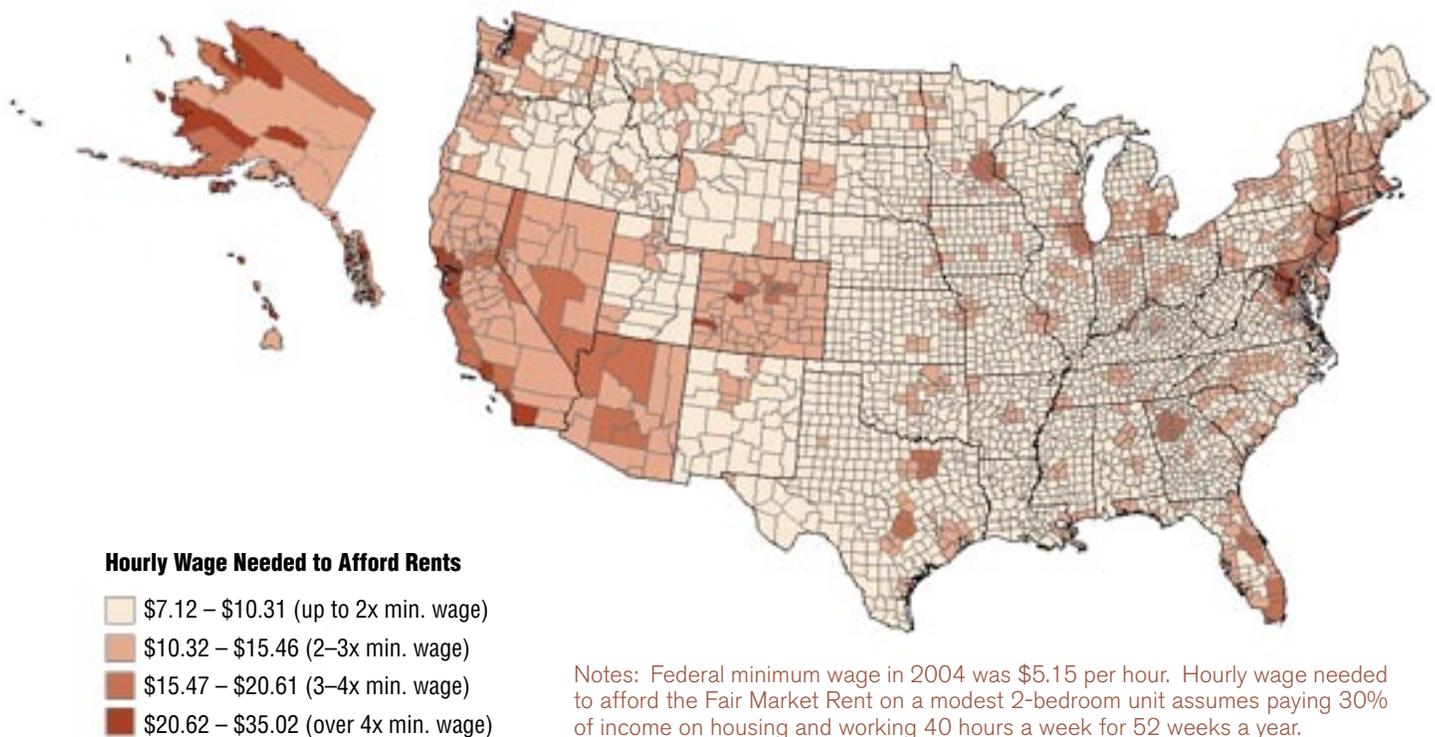
Housing affordability problems are no longer limited to those with very low incomes. Community development programs and public subsidies for housing—as well as Community Reinvestment Act (CRA) consideration—traditionally have been targeted at those earning 80 percent of the area median income (AMI) or below. In high cost areas, the assumption that someone earning the median income can afford the median price of housing is no longer true. As Linda Wheaton, Assistant Deputy Director of California's Department of Housing and Community Development, notes, "We see more families struggling with housing needs not only at the very low income side of the scale, but also extending all the way to working families earning the median income and above. We have to address the needs of a much broader range of families." While some government

programs have adjusted their programs to address the high cost area issue, in many cases the adjustments don't go far enough (Box 1.1: Adjusting Limits to Account for High Cost Areas).

As housing affordability problems work their way up the income ladder, federal subsidies are on the decline. Exacerbating the problem is that the federal subsidies that do exist don't go as far as they used to. High land, labor, and construction costs force up development costs, requiring more public subsidy per unit built. Trends in the use of Low Income Housing Tax Credits (LIHTC) provide an apt example.¹⁶ Between 1993 and 2003, the total annual allocation for the LIHTC increased from \$425 to 572 million. However, the average allocation needed to produce a low-income unit has nearly doubled, from \$4,000 in 1993 to \$7,700 in 2003. One million dollars in tax credits in 2003 only supported the construction of 129 affordable housing units, compared to 244 units just ten years earlier (Figure 1.6).

Moreover, as the largest source of federal funding for low-income housing development, competition for LIHTC allocations is fierce. Antonio Manning, First Vice President and Regional Manager of Washington Mutual, says that "it's becoming increasingly difficult to finance low-income multi-family developments. The lack of land makes project development difficult, and the allocation of Tax Credits is extremely competitive, with a number of groups competing for the same deals. We're all striving to build more affordable units, but particularly in high cost states like California, ultimately it's going to take more public subsidies to leverage private investment." The promise of

Figure 1.5. Even Modest Rental Housing is Beyond the Means of Many Low- and Moderate-Wage Workers



increased federal funding for affordable housing is unlikely to be realized. Although HUD's budget for 2006 seems to have been saved from the immediate chopping block, the Administration will probably continue to propose deep cuts in community development and housing programs in the near future.¹⁷

Developing Solutions to the Affordable Housing Crisis

The combination of escalating housing prices, stagnant incomes, and declining federal funds paints a bleak picture, and poses a community development challenge without an easy answer. And while the ultimate solution may not be close at hand, local governments, architects, planners, developers, nonprofits, and financial institutions have all been working together to ease the housing crisis through innovative policies and programs.

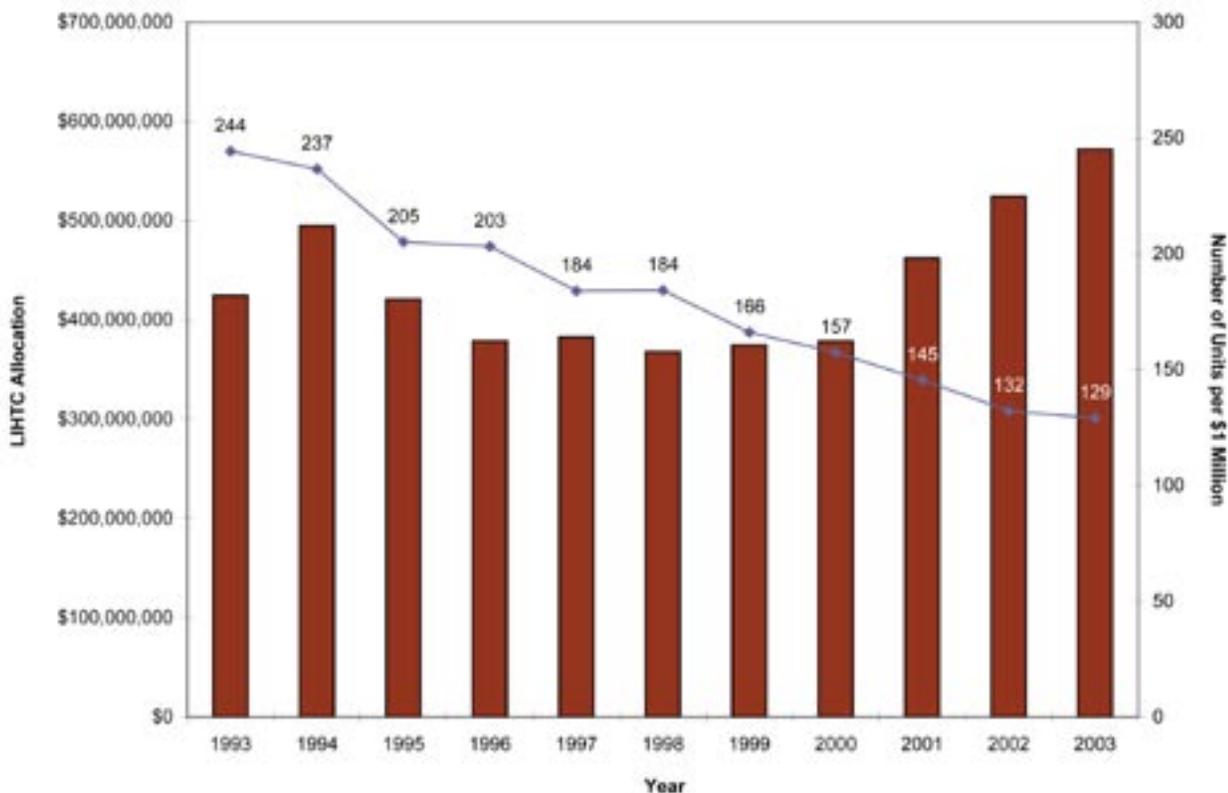
The reduction in federal support for housing, for example, has had an unintended consequence: increasingly, local and state governments are stepping in to fill the gap and are using a variety of tools to meet the demand for affordable housing (see article: *"Innovations in Housing Policy"*). One promising approach on the finance side is the development of housing trust funds, which dedicate public funds for the production of affordable housing and help to leverage private capital for housing development. More than 350 local and statewide housing trust funds have been formed in the United States, and debates are underway in Congress

to establish a National Housing Trust Fund (see article: *"State Housing Trust Funds"*).¹⁸ Local jurisdictions are also spurring the production of affordable housing through the controversial, though effective, tool of inclusionary housing ordinances, which either mandate or encourage developers to construct affordable units as part of new developments (Box 2.1: Inclusionary Housing). While critics contend that these policies only serve to raise construction costs and force up the prices for market-rate homes, inclusionary housing ordinances nevertheless pursue the important goal of providing affordable housing in high cost communities, rather than forcing low-income families to live in distant suburbs or segregated communities.

In addition to public sector finance and regulations, nonprofits and private developers are pursuing creative solutions that reduce the costs of construction or operating costs, for example, through the use of manufactured housing (see article: *"Some Assembly Required"*), green design, and smaller units (see Boxes 3.1 and 6.1). Private investors have been at the forefront of financing workforce housing initiatives to help middle-income households buy their home in high cost cities in California (see article: *"Stuck in the Middle"*).

Private developers and nonprofits are also looking for opportunities to use vacant land for infill development, or to convert old buildings to new uses. John Stewart, founder and Chairman of the John Stewart Company, a private developer that has extensive experience in providing

Figure 1.6. As Development Costs Rise, Government Subsidies Don't Stretch as Far



affordable housing, notes that building affordable housing in the current environment requires resourcefulness in seeking land for development. “Each community is different, and you need to focus on local needs and opportunities,” says Stewart. “You’re not going to find a perfect piece of land that can be had for a nickel. Abandoned lots, buildings that are not complying with code, or old warehouses can all be developed into mixed-income housing, to the benefit of the community.” Mercy Housing, a national nonprofit housing organization, has been working with community hospitals and medical centers to identify underutilized hospital property that can be converted or redeveloped into affordable housing developments.

Perhaps the most important development has been the growing recognition that neither the public nor private sector can go at this alone. Public/private partnerships that leverage multiple sources of financing are emerging as the hallmark of affordable housing development in high cost areas. “You can give up the idea that you’re going to fund the project from one source or one grant. An affordable

housing development often requires six or seven layers of financing, from both public and private sources,” says Stewart (Box 1.2: North Beach Place). Manning similarly sees partnerships between financial institutions and nonprofits as the key to success. “At Washington Mutual, we work to identify partnerships with nonprofits in order to leverage a wide range of funds and expertise. Partnerships are the name of the game today. None of us can tackle the challenge of building affordable housing alone.”

Conclusion

Providing affordable housing in any community is a challenge, requiring the creative, persistent, and collaborative efforts of government, developers, investors, lenders, and community organizations. In high cost areas, the demand for affordable housing challenges these networks to be even more creative and more persistent to ensure that even high cost areas can be home to the full spectrum of workers and families that make a community healthy and vibrant. 

Adjusting Limits to Account for High Cost Areas

Box 1.1

To address the specific needs of high cost areas, some government agencies and programs have included special designations to accommodate for geographic variations in house prices. For example:

Low Income Housing Tax Credit

The Low Income Housing Tax Credit program includes a special designation for areas with high construction, land, and utility costs relative to the surrounding region. Known as “Difficult Development Areas” (DDAs), these areas are eligible for Tax Credits at 130 percent of qualified basis, meaning that more of the development costs are borne by the Tax Credit funding than in areas not designated a DDA. HUD determines the DDA thresholds annually by comparing local incomes with housing costs.¹

The Federal Housing Administration

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders. In high cost areas, FHA will insure loans up to \$312,895 for a one-unit mortgage, compared to \$172,632 in a non high cost area. In Alaska and Hawaii, limits can be even higher. For example, in Honolulu, Hawaii, the limit for a one-unit dwelling can be as high as \$469,342. A complete schedule of FHA mortgage limits for all areas is available at <https://entp.hud.gov/idapp/html/hicostlook.cfm>.

Raising Conforming Loan Limits for GSEs

Congress is considering a proposal to raise the conforming loan limits for Government Sponsored Enterprises (GSEs) in areas where the costs of buying a home are high. Currently, Fannie Mae and Freddie Mac are governed by a law that puts a ceiling on the size of the mortgages that they can buy. For 2005, the conforming loan limit is \$359,650, and it's the same for all contiguous 48 states.² By raising the loan limit, Fannie Mae and Freddie Mac would be able to purchase more new mortgages in high cost areas. In theory, the resulting lower interest rates would be passed on as cost savings to home buyers whose mortgage loans are purchased and securitized by the GSEs, although the actual benefit is uncertain.³

Even with these adjustments, however, many of the existing or proposed limits still fall short of addressing the costs of housing in places like California. For example, even if the conforming loan limit for GSEs in high cost areas were increased to \$539,450 (as under the current proposal), the median price of homes in the San Francisco Bay Area in June of 2005 was 35 percent higher still, at \$734,610.

Financing Affordable Housing in High Cost Areas¹

The challenge: take 229 units of dilapidated public housing built in the 1950s, rife with unemployment, crime, and drug abuse, and turn it into a vibrant mixed-income community.² If that's not hard enough, do it in San Francisco, one of the most expensive housing markets in the country, where a 2-bedroom apartment rents for an average of \$1,539 a month.³

The result: North Beach Place. Opened in late 2004, North Beach Place includes 341 new apartments, all of which are set aside for low- and very low-income families, as well as a separate building with 47 units for low- and very low-income seniors. The development also includes a childcare center, a community center, a computer learning center, landscaped courtyards and playgrounds, a business-incubator space for resident entrepreneurs, and a computer/technology center. North Beach Place has easy access to several bus lines and a cable car line, and has structured parking for residents and retailers. To top it off, the two-city-block development includes approximately 17,000 square feet of commercial space, which houses a Trader Joe's, a coffee shop, and a tour agency.⁴

It would be a mistake to say that revitalizing North Beach Place was easy. The project took seven years to complete, with federal budget cuts, a scandal at the housing authority, and problems with resident relocation all contributing to the project's difficulty.⁵ What is particularly notable about the construction of North Beach Place, however, is the multiple layers of both public and private financing.

Critical to the project's success was the allocation of Low Income Housing Tax Credits. Related Capital Company acquired \$38.5 million in 9 percent federal tax credits and \$17.1 million in California state tax credits, raising \$48 million in net proceeds for the project. The major investors in the tax credits included Bank of America, which contributed \$25 million in equity, and HSBC, which contributed \$23 million. The money raised through the tax credit was then used to buy down Citibank's \$54.9 million construction loan to approximately \$24 million in permanent financing, reducing the long-term costs of the project and allowing the units to be leased at below market rates.

The co-developers—BRIDGE Housing Corporation, The John Stewart Company and Em Johnson Interest—secured \$23.2 million in HUD HOPE VI funding. To raise additional public funds, developers turned to the City of San Francisco's Mayor's Office of Housing, which provided \$10 million in the form of a 55-year loan, with a 3 percent interest rate. Another significant factor in making the project financially feasible was that the upfront land acquisition costs typically associated with new developments were avoided. The site is owned by the San Francisco Housing Authority and has been leased to North Beach Housing Associates for 75 years. Initially, the project developers faced difficulties in trying to secure a loan subject to a ground lease to a housing authority, and appreciated Citibank's willingness to commit to funding the project early on.⁶ BRIDGE also won a competitive grant of \$1 million through the Federal Home Loan Bank's Affordable Housing Program.

The project's financing illustrates the importance of public/private partnerships for making affordable housing in high cost areas feasible. Financial institutions play a critical role in financing these mixed-income community development projects. While deals like North Beach Place are far from easy to assemble, they are often highlighted as exhibiting an exceptional amount of innovativeness and complexity during CRA examinations, and more importantly, translate into real benefits for neighborhoods.

The before-and-after of the interior courtyard of North Beach Place.

Photo Credit: Robert Canfield





Innovations in Housing Policy

The Evolving Role of Local Government

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The US housing affordability crisis afflicting our highest-cost metropolitan areas is a dilemma of national dimension. But dreams of a national housing safety net—akin to the socialized programs familiar in Europe and elsewhere—have long since faded away. In the face of perennial shortfalls in federal subsidy and oversight, local government's role in the promotion of affordable housing has evolved considerably, both in terms of leadership and policy innovation. Indeed, local initiative is increasingly making the difference between areas making real progress on their housing problems and those just treading water.

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A number of local functions in housing are organic in nature, part of the customary ambit of city and county governance within federal-state civics. Beyond their role as administrators of supply- and demand-side subsidies, local authorities engage in a variety of everyday policymaking affecting housing markets and household welfare, including rent control, property taxes, land use plans and zoning regulations, and infrastructure provision, to name just a few.

Augmenting these traditional areas of local policy, additional responsibilities once managed in Washington have been devolved to the states. For more than a generation, the political vanguard has championed shrinking of the federal role in addressing social needs, arguing that local authorities are more able to shepherd resources, assess need, and finesse political obstacles. Local prerogative dictates outcomes for the Low-Income Housing Tax Credit, HUD's HOME, CDBG, homeless-aid and other federal funding.

In this decentralized context, the downside is that there is great variation in energy and vision among jurisdictions, with some localities underperforming on measures of service delivery or housing stock enhancement. But with the emphasis on the local role, there is room for the cultivation of a thousand flowers blooming, and there are numerous examples of creative, progressive local initiatives in housing. The balance of this article surveys some interesting mechanisms in the field: 1) private activity bonds, 2) community land trusts, 3) down payment assistance, and 4) promotion of infill development. Each features opportunities for municipal leadership in addressing urgent housing need.

Private activity bonds, mortgage revenue bonds, and mortgage credit certificates. States and local jurisdictions can raise funds through the sale of tax-exempt Private Activity Bonds (PABs), which may be used to finance affordable multifamily developments or provide funds for low- and moderate-income homebuyer assistance. PAB funds can also be used for other public needs such as airports, sewers, industrial parks, and student-loan programs. States are allotted a debt limit for such bond issuances; the limit set in 2002 for all purposes under this mechanism was the larger of \$225 million or \$75 per state resident, and these amounts have since been adjusted for inflation annually.

PABs comprise an important funding stream for local community development. During the 1990s, housing accounted for nearly half of all PAB issuances by dollar value. PABs help lower interest costs relative to those offered through private commercial financing. Developers often receive funds through a competitive application process, and PAB proceeds are typically used in conjunction with other public and private housing financing programs such as Low Income Housing Tax Credits.

Two additional ways of spending PAB debt allocations offer alternatives to traditional project funding. Mortgage revenue bonds support local programs providing below-market-rate mortgages to qualifying households. Mortgage credit certificates (MCCs) allow low-income homeowners to claim tax credits against their mortgage interest payments.

Unlike the mortgage-interest deduction, which reduces the amount of income on which the homeowner pays taxes, MCCs reduce the homeowner's federal tax bill directly, generally by around 15 percent.

In California, MCCs represent one of the largest state housing subsidy programs in terms of dollar value, with \$4.1 billion allocated during the 1990s. Localities apply to participate in the program, receiving allocations of awardable credits from the state and then granting those credits to qualifying households. By law every dollar of PAB proceeds utilized in this fashion must be granted in the form of issued MCCs; program administration must be financed through fees collected from applicants and participating mortgage lenders. Successful MCC programs depend in large part on the initiative and foresight of local agencies, which advertise them both to homebuyers and the networks of private lenders needed to package the subsidy within complex affordable-mortgage transactions.

Nationally only about 75 percent of the potential dollar-value for housing and other purposes is placed in eligible bonds at the state level under the pertinent provisions of federal tax law. Given the bond capacity that is left on the table, local government initiative is needed toward increasing the portion of debt limit used for multifamily development and mortgage assistance programs.

Down payment assistance programs. Local governments are also increasingly providing down payment assistance to first-time homebuyers, which can be particularly important in areas where median house values place ownership out of reach for many families. In addition, the benefits of down payment assistance policy often are concentrated among minorities, thereby helping to close the homeownership gap. While several localities have provided down payment assistance for years, the concept received a substantial boost with the enactment of the American Dream Downpayment Assistance Act of 2003. The Act authorized \$200 million annually to be administered via the states and other participants in HUD's HOME Investment Partnerships Program.

Several different models of down payment assistance exist. Funds are provided to qualifying households either as loans or grants, or both: hybrid programs gradually forgive loaned amounts over time so long as the borrower avoids default. The lender's security interest may even be allowed to dissolve entirely, once a five- or ten-year "recapture" period expires. In San Diego, for example, families earning below 80 percent of the area median income can receive grants of up to \$15,000 toward a down payment or closing costs. The grant is "recoverable," meaning that if the buyer sells within six years, it needs to be repaid. Localities may also target down payment assistance funds toward specific groups within the moderate-income workforce, such as local workers, teachers, nurses, and public-safety personnel.

State housing finance agencies are also important down



payment assistance providers. The California Housing Finance Agency, for example, operates several such programs, from those requiring junior loans funded by local agencies (sometimes including redevelopment agencies) to those directly funding 100 percent of needed home-purchase finance. The City of Honolulu offers a fifteen-year, zero-interest loan that will fund up to \$25,000 of the purchase price for first-time homebuyers.

Community land trusts. Housing units and the land parcels bearing them are actually separate financial assets, even though they are typically bought and sold as if indivisible. "Community land trusts" (CLTs) purchase and hold the land asset in trust for the benefit of low- and moderate-income households. Such trusts can be public, private or nonprofit entities. By removing land cost from sales and rental transactions, CLTs reduce rent and home prices.

A key issue in operating CLTs lies in characterizing the ownership interest of the occupying household. That interest can comprise absolute fee-simple title to the structure, but need not. Ownership can be framed as a "life estate" enduring for as long as the household-head lives, or as a series of renewable long-term lease arrangements. The right to occupy the CLT's land is conferred through separate lease instruments. Even though the land asset cannot be deployed as collateral by the "owner"-occupant, the value of the collateral can still secure the loan, with the trust serving as co-mortgagor or guarantor, barring state law impediments.

As the land's owner, the trust benefits most directly from any appreciation in land value. CLTs are structured to provide a fair, but only modest, return on homeowners' investments. Therefore, CLTs cannot quite reproduce all the asset-building benefits of traditional homeownership models. But

this private sacrifice contributes to the long-run benefit of later occupants and, more generally, the public's interest in maintaining affordable inventory at sufficient levels. In that respect, CLTs echo the public-trust justifications for conservation and farmland trusts familiar in the environmental field.

The California Community Foundation has recently established the Community Foundation Land Trust (CFLT) in Los Angeles, where in many areas high land costs and speculative investment are driving up home prices. CFLT aims to acquire sites for development to be placed in trust, and will add two features to the standard community land trust model. First, the foundation will serve as private custodian of the land, providing long-term stability relatively unaffected by the changing local political climate. The second element involves a wealth-creation mechanism for buyers through accelerated debt reduction. Land cost often approaches 40 percent of the total construction cost in Los Angeles; in removing such costs from the equation by financing the land through a ground lease, homeowners can pay off in fifteen years what would have taken thirty had they purchased the land as well. The accelerated debt reduction schedule also allows homeowners to build equity more quickly than under standard mortgage terms. CFLT is the first land trust in the nation to incorporate this kind of wealth creation-mechanism within its land trust model.

Promoting infill development. Local government acts as the gatekeeper for development generally, exercising considerable discretion over the grant and denial of applications for residential building permits. Expensive and delayed approval processes eventually contribute toward the runaway prices observed in the highest-cost metropolitan areas. But city planning agencies can work aggressively to leverage costs and delays in permit approvals as a means to increase affordable housing in already developed neighborhoods, or to promote economic development within enterprise zones.

Such "infill promotion" policies offer expedited permit review, reduced permit fees, and other preferences for affordable housing built in specified, distressed neighborhoods. Additionally, height restrictions, density limits, parking requirements, minimum setbacks and sidewalks, and impact fees can all be negotiated—or even forgiven entirely—as a means of encouraging the production of affordable housing units. In turn, more efficient use of land and densification of existing neighborhoods effectively eases price pressures in high-cost areas and can increase housing options near transit centers and encourage community revitalization.

The City of Phoenix, Arizona established its "Infill Housing Program" by ordinance in 1995. An inventory showed

that approximately 121 square miles of vacant land suitable for residential development existed within the urban area. Building on this vacant land would accommodate nearly 500,000 new residents and would help to control sprawl, traffic congestion, and air pollution. The program focuses on encouraging single-family construction for homeownership on vacant or underutilized parcels. To qualify, parcels must be located within 1,000 feet of existing housing and within 500 feet of buildings with median ages over 20 years. By meeting these and other criteria, developers get certain water and sewer fees waived, are considered for city contributions toward needed off-site improvements, and receive expedited staff attention, including support at hearings before appeals boards and the city council.

... it will only become more critical for local governments – as well as advocates and builders in private and nonprofit housing industries – to be as efficient and creative as possible in addressing dire problems of affordability in high-cost areas.

The federal government has reduced its spending on housing and urban development substantially since the 1970s. HUD's budget has rebounded somewhat since reaching its modern nadir during the Reagan Administration, but its overall spending authority is still less than half what it was thirty years ago. If national resources can simply be maintained at current levels over the next decade or so, that outcome would be a substantial political achievement.

Under these circumstances, it will only become more critical for local governments – as well as advocates and builders in private and nonprofit housing industries – to be as efficient and creative as possible in addressing dire problems of affordability in high-cost areas. The approaches described in this article are parts of a diverse and growing policy toolkit used by local and state leaders. Perhaps most important in this effort is the full exploitation of off-budget resources provided by the capital markets via tax-credit and tax-expenditure incentives. No less imperative is the appropriate reform of local regulatory and political barriers standing in the way of proposed construction. ■

While affordable housing is generally squeezed out of high cost housing markets, there is a potential silver lining for affordable housing development in such areas. Local authorities can employ developers' eagerness to build in these markets to spur the production of affordable units along with the market-rate housing units they hope to build. For example, some local governments offer cost offsets or incentives to developers who voluntarily agree to set aside a certain percentage of housing units for low- and moderate-income households within otherwise market-rate developments. Alternatively, many localities can require that developers create these affordable housing set-asides by adopting "inclusionary zoning" or "inclusionary housing" ordinances.

Inclusionary programs first appeared in the 1970s and have been adopted by hundreds of jurisdictions around the nation. There is a great deal of variation in the way these inclusionary programs are structured. From the percent of units required to be affordable to the income-targeting of the units to the project size threshold for triggering an inclusionary requirement, each program sets unique performance guidelines. There are also variations in the way developers are brought to the table. Incentives and cost offsets, which are often incorporated into ordinances, can include density bonuses that allow builders to place more units on a site than allowed under the zoning guidelines, fee reductions or waivers, streamlined permitting processes, or reduced parking requirements. Developers are also given the option of building affordable units off-site or contributing in-lieu fees to a housing trust fund rather than building units on-site.

One of the first, and most successful, inclusionary programs is in Montgomery County, Maryland, where the county's Moderately Priced Dwelling Unit program requires a 12.5-15 percent affordability component in both for-sale and rental developments. Montgomery County's program has created 13,000 affordable units in the county over the past 30 years.¹ In California, the 107 inclusionary programs in place as of 2003 accounted for the production of over 34,000 units of affordable housing over the preceding 30 years.²

Despite relative success, inclusionary programs are not without detractors. Critics of inclusionary policies argue that this market-based approach to affordable housing policy shifts the cost of affordable housing production from the public onto private developers. They contend that developers are forced to pass this cost onto market-rate homebuyers, or become so burdened by the added cost that they are dissuaded from developing any housing whatsoever. Claims are made that the resultant decrease in the overall supply of housing raises housing costs for everyone.

Supporters of inclusionary programs note that this argument doesn't hold up under scrutiny. Significant methodological flaws have been identified³ in the 2004 Reason Public Policy Institute report entitled "Housing Supply and Affordability: Do Affordable Housing Mandates Work?," which claimed that inclusionary programs in the San Francisco Bay Area had led to a decline in housing production. A study commissioned for the City of Los Angeles found that in California, inclusionary housing programs over a 20 year period (1981-2000) had not had a negative effect on overall housing production, and that most jurisdictions with inclusionary programs saw an increase in housing production.⁴

Arguments also crop up around the notion that inclusionary zoning constitutes an illegal "taking" by government since potential profits are reduced due to the requirements to construct affordable units. Legal precedent, however, has established the constitutionality of soundly structured and fairly applied inclusionary ordinances in areas where there is a clear need for affordable housing.⁵

Some difficulty remains in understanding the effectiveness of inclusionary programs. This is in part because critics and supporters of inclusionary policies often use the same data to argue very different points. For example, the Non-Profit Housing Association of Northern California, an affordable housing advocacy group, lauds the on-average production of 220 affordable units per year in the San Francisco Bay Area, where 57 jurisdictions have adopted inclusionary programs. The Reason Public Policy Institute used this same data as proof that the Bay Area programs were ineffective since *only* 220 units on-average were produced.

More research is needed to determine just how effective this policy measure is in creating affordable housing. In the meantime, high cost areas like Los Angeles, Maui, and Washington D.C. are debating proposals to adopt inclusionary ordinances, aiming to mirror other cities' efforts to translate high real estate demand into increased affordable housing. This is no small order, but is an important endeavor in areas where affordable housing is increasingly difficult to build.

For more information on inclusionary housing, particularly as experienced in California, see:

The California Inclusionary Housing Reader* and *Inclusionary Zoning: The California Experience

Available at <http://www.ilsg.org/inclusionary>

State Housing Trust Funds

Meeting Local Affordable Housing Needs

By Carolina Reid

The history of housing trust funds in the United States is peppered with stories that illuminate both the challenges and benefits of developing new public sources of funding for affordable housing. Take California, for example. In 1985, California was one of the first states to create legislation supporting a housing trust fund, which in theory would have funneled revenue from offshore oil drilling to the production of affordable housing in the state. Advocates cheered the legislation, anticipating funds of around \$20 million each year to be dedicated to affordable housing programs. However, despite its promise, the fund ended up allocating a mere \$2 million a year for affordable housing, most of which was directed in support of ongoing programs like providing emergency shelter. So while California technically had a housing trust fund, it really was in name only.

Then, in 2002, California voters passed Proposition 46, the Housing and Emergency Shelter Trust Fund Act, approving a \$2.1 billion general obligation bond for affordable housing. The revenues from Proposition 46—approximately \$400 million a year—have been directed to downpayment assistance programs, emergency shelter beds for the homeless, and farmworker housing. In the first two years of the program, \$846 million has been spent, helping to build

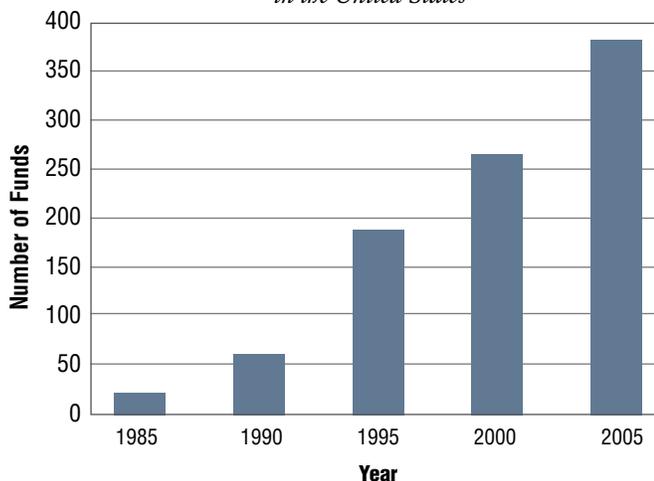
9,212 permanently affordable rental units and 6,927 new and rehabilitated shelter beds, and assisting 13,737 first-time homebuyers and 3,379 farmworker households in securing affordable housing.¹ In addition to these direct impacts, Proposition 46 has helped to leverage private investment, raise public support for affordable housing, and generate interest among municipalities in establishing local housing trust funds.

... it's the existence of a dedicated revenue source that makes housing trust funds unique and effective.

But there's a catch—Proposition 46 is a one-time deal, and the revenues will be exhausted in 2007. In this regard, the proposition still falls short of what California needs: a housing trust fund with an ongoing, stable revenue source. Mary Brooks, of the Center for Community Change and a leading expert on housing trust funds, says that it's the existence of a dedicated revenue source that makes housing trust funds unique and effective. One-time infusions of money that are reliant on government appropriations are subject to the whim of politicians and budget cycles. An ideal housing trust fund, on the other hand, provides long-term, steady financing for affordable housing. "If we have any hope of addressing the housing affordability crisis," Brooks notes, "it'll be through a combination of national, state, and local housing trust funds, each with dedicated revenue sources that provide affordable capital for housing year after year."

An ambitious goal, but one that appears to be gaining public support as concerns about housing affordability move up the income ladder. Since their emergence in the mid-1970s, the number of Housing Trust Funds in the United States has risen dramatically (Figure 3.1).² Today, there are more than 350 housing trust funds in cities, counties and states across the country, and this number is constantly growing. With the exception of Alaska, all of the states within the Federal Reserve's 12th District have some version of a housing trust fund on the books, and many states in the district are also home to city, county, and regional housing trust funds.

Figure 3.1. *The Growth of Housing Trust Funds in the United States*



Even though they share a common name, housing trust funds differ greatly in the details of their revenue source, their administration, and their program design. Nearly forty different sources of revenue have been identified as part of existing housing trust funds, including real estate taxes or fees, developer fees, property taxes, tax increment funds, or interest from government-held and/or market-based accounts. Funds also vary widely in the amount of annual revenue they collect, ranging from a high of around \$300 million to less than \$100,000 annually. In fact, perhaps the only thing they all have in common is that they direct non-federal public funding to affordable housing programs.³

The diversity of housing trust funds is also their strength. Unlike many federal housing programs, housing trust funds can be designed to draw on local resources, and can be tailored to local needs. To illustrate some of the ways in which housing trust funds work, profiled here are four of the state level trust funds in the 12th District.

Arizona

Arizona passed its statewide housing trust fund in 1988. Rather than imposing new taxes or fees to support the program—an unpopular proposition in almost any locale—Arizona’s trust fund receives 55 percent of the revenues from unclaimed property. Unclaimed property comes from “inactive bank accounts, deposits, lay away fees, and unclaimed refunds” in lending institutions, insurance companies, and commercial retail operations. Although most amounts are very small, the value of this revenue stream has risen to about \$20 million a year. Since its inception, over \$130 million has been made available to the fund for affordable housing related purposes.⁴ Approximately one-third of the monies in the fund must be spent in rural areas. Arizona’s Department of Housing coordinates the application procedure for the trust fund monies with their federal HOME allocations, allowing nonprofits, developers, and local governments to submit a single application to access multiple funding sources. Arizona is also one of the few states in the country that dedicates trust funds to tribal projects, in recognition of the affordable housing needs of the large number of Native Americans in the state. In both 2004 and 2005, the housing trust fund allocated \$2.5 million for affordable housing programs on tribal lands.⁵

Hawaii

Hawaii has had its rental housing trust fund in place since 1992, which is funded by a real estate conveyance, or transfer, tax.⁶ In 2004, the conveyance tax netted about \$15 million, of which 25 percent went to the rental housing trust fund.⁷ In June of 2005, Governor Linda Lingle approved a measure to increase the conveyance tax, which historically had been the lowest in the nation.⁸ Reflecting the impact of tourism on Hawaii’s property values, the increase in the tax is targeted at luxury and vacation properties. The transfer tax for home sales under \$600,000 will remain the same at 10

cents per \$100, but the tax will increase to 25 cents per \$100 for properties valued between \$600,000 and \$1 million, and to 30 cents for those valued at more than \$1 million. Non-Hawaiian residents will pay 5 cents more per \$100 for each of the property value thresholds, for example, 35 cents per \$100 for properties valued at over \$1 million. The law also changes the allocation of the conveyance tax, with 30 percent now going towards the rental housing trust fund. The new law will provide the rental housing trust fund, which provides loans and grants to builders of affordable rentals, about \$10.8 million annually, up from the current \$3 million to \$5 million.⁹

Unlike many federal housing programs, housing trust funds can be designed to draw on local resources, and can be tailored to local needs.

Utah

Utah’s fund, The Olene Walker Housing Loan Fund, does not have a dedicated revenue stream, and derives its funding from grants that the U.S. Department of Housing and Urban Development allocates to Utah State, as well as from legislatively appropriated funds. In 2005, approximately \$7 million was directed to the fund, of which \$2.4 million was appropriated from the state legislature. The Olene Walker Housing Loan Fund is set up as a revolving loan fund, and has total assets of around \$60 million. The fund targets a wide range of initiatives from developing multi-family rental properties to helping elderly rural homeowners with rehabilitation or improvement loans. For example, last year the fund supported the rehabilitation of the Villa South apartments in Ogden, which consisted of 120 affordable units serving households earning below 40 percent of area median income (AMI). The project received a loan in the amount of \$960,000 to help acquire and rehabilitate the existing property, including replacing all of the heating and electrical systems.¹⁰ On the other end of the spectrum, in the small rural town of Ivins, the fund provided a low-income household a loan of \$7,975 to replace the windows and siding on its mobile home, charging only 2 percent interest for 10 years.

Washington

Washington established the Washington Trust Account in 1988. Initially, the legislature allocated \$2 million from real estate escrow accounts held by the state, and ascribed penalties from the failure to pay real estate transfer taxes to the fund. In the early 1990s, the legislature boosted the amount in the Trust Account through an appropriation from the capital budget, funded through a capital bond allocation.

This year, the state legislature committed \$100 million from this source, the largest contribution to date. In 2002, efforts by housing advocates led to the passage of legislation authorizing counties to increase document recording fees by \$10.¹¹ The surcharge has already generated \$19 million for local governments, which have control over how to direct the funds, and about \$12 million for the state.

Idaho, Nevada, and Oregon also all have housing trust funds that are adapted to emphasize local priorities. In Oregon, for example, projects funded through its housing trust fund must include a resident services component, for example, providing financial literacy classes, daycare, or referrals to a job training program. In Nevada, trust fund dollars are targeted to those earning below 60 percent of AMI, in an effort to help low-wage workers priced out of Nevada's

burgeoning real estate market.

Although not all states have established the ideal trust fund with a dedicated revenue stream, more and more state and municipal governments have recognized the need for identifying local funding for affordable housing. According to Washington State Representative Hans Dunshee, the public investment is well worth it. "In Washington, the housing trust fund is a critical part of our strategy to provide affordable housing, and the funds are often what puts a project in the black and gets it built. The challenge now is to do more. Out of a total \$2.4 billion budget, \$100 million is just a drop in the bucket. What if funding went to \$200 or \$300 million? With our skyrocketing house prices, we need to keep thinking big and innovating to ensure that we're creating a just society in which everyone has a safe and affordable place to live." 

Not just your granny's flat

Box 3.1

By any measure, Santa Cruz County, California is one of the least affordable housing markets in the nation. Median home prices there hit a record high of \$785,000 in June of 2005, leaving only 11 percent of county residents able to afford a median-priced home.¹ Rents there are also some of the highest in the nation, with two-bedroom apartments only truly affordable to renters earning more than \$25 an hour.²

As one of their measures to increase housing affordability, the City of Santa Cruz has implemented a series of permitting and zoning changes meant to encourage the construction of accessory dwelling units (ADUs), also known as "granny" or "in-law" flats. These housing units are small, self-contained secondary apartments on the same lot as residential buildings, built either within the building envelope or as an addition or conversion of a detached garage or carriage house. The units represent additions to the affordable rental stock of a given community and can offer housing opportunities for low-income workers and seniors.

Santa Cruz encourages the construction of ADUs through simpler and shorter permitting processes, and offers incentives such as technical assistance for homeowners seeking to design and construct ADUs, wage subsidies for ADU builders who employ graduates from the county's building trades training program, and low interest rate loans for owners making their units affordable to persons earning below 80 percent of area median income (AMI). The city has also published a manual for ADU production. The State of California supported the program through a \$350,000 Sustainable Communities Grant, and the program has received awards from planning, architectural, and environmental groups.

Santa Cruz is ahead of the curve in establishing their ADU ordinance. In many areas, zoning and building codes often restrict the development of ADUs, and inspectors in some jurisdictions seek to remove existing ADUs from the housing stock, citing them as illegal units out of compliance with code. Communities sometimes object to ADUs out of concern that increased residential density will put pressure on the availability of parking and otherwise disturb the character of the neighborhood.

But providing affordable housing opportunities through ADUs offers a number of community benefits. ADUs take shape as small-scale development with minimal disruption to neighborhood aesthetics. As infill development, ADUs offer affordable housing without requiring additional land or infrastructure, thus contributing to efficient land-use patterns and "smart growth." ADUs benefit homeowners because extra income from secondary units can contribute to the owner's mortgage payments. In addition, ADUs require no public funds and result in the expansion of less-expensive housing across scattered sites rather than concentrating units in one area.

ADUs offer a means to provide affordable housing units in an efficient and neighborhood-compatible way, and carefully constructed ADU ordinances can alleviate community concerns and allow for proper regulation of the units. ADUs can be considered as an important component of the affordable housing toolkit, particularly in higher cost areas where both subsidies and land for affordable housing development are scarce.



Some Assembly Required

Using Manufactured Housing in Affordable Housing Development

By Naomi Cytron

OCHI's Infill Homeownership Initiative at 94th & E Street in Oakland

Chances are that when you hear the term manufactured housing, the image that comes to mind is that of a dilapidated trailer park set off on the outskirts of town. But this image does not come close to matching how manufactured housing, which has improved dramatically in quality and design over the past decade while still maintaining low per-square-foot costs, is currently being used to provide affordable housing opportunities. Particularly in areas where the cost of construction has skyrocketed, nonprofit developers are taking advantage of advances in the manufactured housing industry to create new housing options for low- and moderate-income buyers.

There is a great deal of confusion regarding the terminology delineating the various forms that manufactured housing can take, which often leads to the “trailer park” misconception noted above. The outmoded term “mobile home” only refers to a unit built before 1976 under voluntary industry standards, and that product is quite different than a “manufactured home,” which again is distinct from a “modular” or “pre-fabricated” home. Manufactured homes, which are being employed most vigorously in the construction of affordable housing, have a metal or wooden chassis but can be permanently attached to site-built foundations and garages after leaving the factory as a fully assembled unit. Manufactured housing is regulated by construction and performance standards set by the U.S. Department of Housing and Urban Development (HUD). HUD codes supersede local regulations, creating efficiencies through product standardization and avoidance of delays from local inspections.

Modular housing is another form of factory-built housing that is gaining some momentum in use, due in part to architects across the nation using modular units to bring innovative design to the masses in an affordable and earth-friendly manner. Here, house “modules,” such as the kitchen or the

living room, are produced in a factory and then assembled into one unit on-site. These houses are built to local building codes rather than HUD code.

Developers looking to reduce construction costs have caught onto the efficiencies presented by factory-built housing.

Modern factory-built housing offers a cost-effective means of siting housing in a variety of settings. According to the Manufactured Housing Institute, the industry’s trade group, the average cost per square foot for a new manufactured home is less than half that of a site-built home (excluding land costs). More importantly, significant advancements in the industry in engineering, transportation, and materials technologies now allow for the construction of two-story manufactured units with pitched roofs, vaulted ceilings, and customizable exteriors, leading to a product that is indistinguishable from its stick-built counterpart.

Developers looking to reduce construction costs have caught onto the efficiencies presented by factory-built housing. HomeSight, a nonprofit community development corporation in Seattle, Washington dedicated to promoting affordable homeownership opportunities, was one of the first developers in the nation to utilize two-story manufactured units in constructing Noji Gardens, a 75-unit project incorporating single-family manufactured homes and townhomes with site-built houses. Using manufactured units for this development offered both cost and time savings



Market-rate and affordable manufactured homes at Homesight's Noji Gardens in Seattle

for HomeSight while allowing them to match the quality of site-built housing in their other developments. Homes were sold at prices 20 percent lower than Seattle's median home prices, with eligible buyers earning below 80 percent of area median income (AMI). Buyers were offered creative financing packages that included downpayment assistance and property tax abatements.

Nora Liu, Project Manager for Noji Gardens, said that when HomeSight was conceiving this project five years ago, they did not know what the level of acceptance for manufactured housing would be from the community. But the pilot units sold before construction was complete, and the rest of the homes were sold successfully. In addition, Liu said that the manufactured homes have appreciated at the same rate as the site-built homes in the area.

Liu noted that construction using manufactured housing raises some unique technical issues. Bringing housing to a site by truck requires careful consideration of road and site constraints, and the logistics of dropping the houses onto foundations by crane necessitate expertise on the part of the installer. In addition, some of the cost and time savings accrued through the use of manufactured housing at Noji Gardens were lessened by adding site-built elements such as garages. However, Liu said that these site-built additions were what allowed the homes to achieve design standards appropriate to the goals of community development and kept the homes from being just "double-tall rather than double-wide." Despite these limitations, HomeSight has found success in using manufactured housing in their affordable housing developments and is implementing lessons learned from previous projects as they continue to develop the use of manufactured housing.

Oakland Community Housing, Inc. (OCHI), a nonprofit housing developer that produces and manages both rental and homeownership units in Oakland, California, has taken a slightly different approach to utilizing manufactured housing for affordable housing development. In an effort to foster the reuse and revitalization of small and underutilized urban parcels scattered throughout Oakland, OCHI began to acquire empty and blighted lots through the California state law that allows tax-defaulted property to be sold to nonprofit housing developers who intend to convert them into housing opportunities for low-income households. The question for OCHI was how to cost-effectively develop housing on these small, scattered sites.

Eleanor Piez, OCHI's Director of Community Relations, noted that in looking for effective models, they found little local activity that used manufactured units to create affordable housing. But OCHI had strategic interests in orienting their work toward smaller projects with faster development timeframes and also saw the need to grow less dependent on increasingly competitive allocations of public funding. At the same time, they recognized that the manufactured housing industry was becoming more sophisticated and was developing the capacity to work with nonprofit developers with the agenda of promoting overall community health. With this convergence of factors, OCHI's manufactured homeownership development program, the Infill Homeownership Initiative, was developed.

... the potential of manufactured housing should only grow, particularly in areas where creativity is needed to override the obstacles to affordable housing development.

OCHI's first manufactured housing project, dubbed the 94th and E Street project, is a 4-unit development in East Oakland sited on a lot that had been used for upwards of 20 years as a site to dump trash in an otherwise residential neighborhood. OCHI was able to subdivide the lot, construct an adjacent street, and customize the homes on-site so that they fit into the context of the surrounding neighborhood. The homes are being sold at market-rate prices, but OCHI is making the homes affordable to households earning less than 80 percent of AMI through layered homebuyer subsidies. This pricing approach stems from OCHI's goal of economic empowerment for its buyers—their strategy is intended to allow low- and moderate-income homebuyers to build assets through ownership in the same way as higher-income buyers. OCHI has a number of other projects using manufactured units in their development pipeline, ranging from a single-unit infill project to a novel schematic for a multifamily project that would site manufactured units on top of a traditionally constructed, ground-floor commercial structure.



OCHI's multi-story manufactured townhomes under construction at Linden A in Oakland.

Amanda Kobler, Project Manager for the 94th and E Street project, noted that OCHI's infill strategy not only is allowing low-income families to access homeownership opportunities, but is also contributing to overall neighborhood stabilization and the transformation of a "gap-toothed" neighborhood into more a vibrant and cohesive community. In the past year alone, a number of homeowners on the blocks adjacent to the development have invested in home improvements and are rehabbing or even completely rebuilding their homes. "The project has made a huge impact on the street, and the homeowners there are thrilled at what in some ways is a renaissance of East Oakland," said Kobler.

There were some hurdles for OCHI to overcome in pursuing the use of manufactured housing, including the general prejudice against what has been perceived as "trailer homes." Additionally, OCHI found that for manufacturers and dealers of factory-built housing, working with affordable housing developers is relatively uncharted territory. Dealers have historically been set up to sell houses to individuals off the lot the way cars are sold, rather than thinking in terms of a continuing relationship with a developer working to put a number of units on sites with different requirements as far as configurations and exterior aesthetics. While some manufacturers are beginning to staff architects and engineers to

interface with developers to smooth this process, this can raise complications akin to having too many cooks in the kitchen. An understanding of the differences in language and culture of each industry is key to a good working relationship between manufacturers and developers.

A number of the financing elements for manufactured housing are also still a challenge. Because the timeframe for construction on manufactured units is shorter than for traditional construction, standard loan draw-down schedules may not be appropriate, and more flexibility is needed in structuring arrangements with lenders (For information on the financing of another OCHI manufactured project, see Box 3.1: Financing Manufactured Housing). For buyers, unfavorable interest rates are common because homes are often titled as personal rather than real property, and there is still some hesitation on the part of lenders to extend mortgage loans for manufactured homes because there is a lack of understanding of the stability and quality of modern manufactured housing. Another issue is that appraisals are often discounted simply because the units are manufactured or because there are not very many comparable units in the area. On the whole, more education is needed in the finance industry on the value of manufactured products.

In an effort to promote understanding of manufactured housing as an affordable housing issue and to increase its potential to serve as an asset-building housing opportunity, CFED, a national nonprofit that works to expand economic opportunity, has recently launched the Innovations in Manufactured Housing (I'M HOME) initiative. This program, slated to be a 5-year initiative, will provide grants for demonstration projects and offer a platform for collaboration and knowledge sharing among grantees. I'M HOME is meant to draw out best practices in the field, build capacity among developers, and inform the public, practitioners, and policy makers regarding the opportunities and challenges of manufactured housing. Chief issue areas for I'M HOME include breaking stereotypes about manufactured housing, addressing shortfalls in mortgage financing, enhancing long-term security for buyers, and tightening consumer protections. CFED intends to leverage the initial multi-million dollar program fund to incentivize additional investment in the sector (visit www.cfed.org for more information).

While there are certainly challenges in using manufactured housing as part of an affordable housing development strategy, the industry is maturing, and nonprofit developers are successfully incorporating manufactured housing into their development portfolios. With greater levels of resources and attention now being turned toward the approach, the potential of manufactured housing should only grow, particularly in areas where creativity is needed to override the obstacles to affordable housing development. As Kathryn Gwatkin Goulding, Program Manager for I'M HOME put it, "If one is trying to produce affordable housing in an increasingly difficult environment, one needs to bring to bear every weapon in the arsenal...and think outside the box." 

Case Study: Linden A, Oakland, California

Sponsor/Developer	<i>Oakland Community Housing Inc. (OCHI)</i>
Construction Lender	<i>Silicon Valley Bank (SVB)</i>
Loan Amount	<i>\$1,987,000</i>
Term	<i>12 months</i>
Targeting	<i>Households earning up to 120 percent of AMI for Alameda County</i>
Per Unit Cost	<i>\$312,512 (Bay Area Median home price exceeds \$500,000)</i>
Per Unit Sales Price	<i>TBD but underwritten at \$270,000</i>
Number of units	<i>8 units in 4 duplexes</i>

Sources for homebuyer first mortgages: California Housing Finance Agency first mortgages (CalHFA); CalHFA downpayment assistance programs including HiCap and CHDAP funds, and the School Facilities Fee Downpayment Assistance Program; and developer equity soft debt.

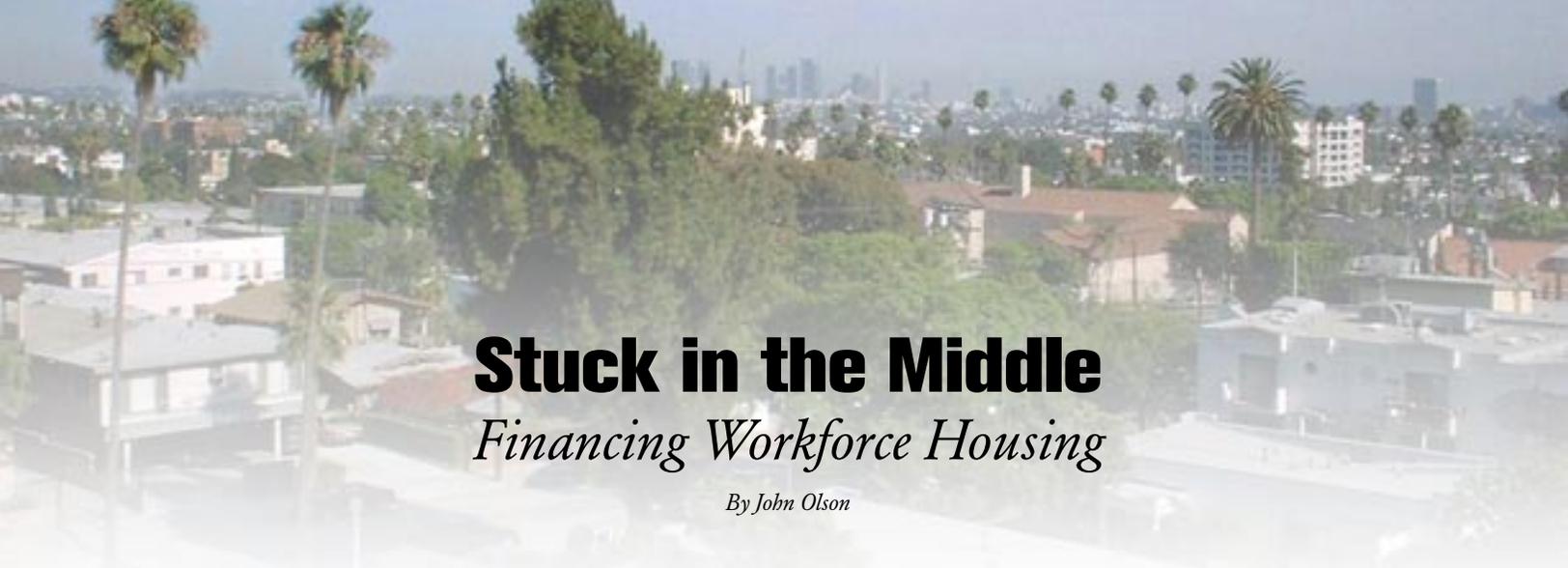
Description: Linden A is a project of eight manufactured housing units. The eight units are in four two-story duplexes over “stick-built” garages. Most units are three-bedroom, three-bath and range from 1,500 to 1,700 square feet. The land was donated by North Oakland Missionary Baptist Church.

Benefits: A reduced cost of construction – about 35 percent below traditional construction – and a reduction in cost and time in the entitlement process were the primary benefits. Due to the cost savings in construction and fees, the project could be completed with only a conventional construction loan, alleviating the need for the time consuming and hence expensive pursuit of public funds. Subsidies will be used in the permanent financing phase to bring the end cost of the homes down for the home purchaser, but these subsidies come through the buyer, not the developer. These programs for permanent financing for homeowners are more plentiful and more easily accessed than traditional subsidies available for affordable housing developers.

Risks: The factory required 50 percent of the construction costs upfront. SVB extended the funds without a guarantee from the factory and without a project to secure. Other banks were not willing to do this for OCHI. While SVB had a first trust deed on the land, the funds needed were more than the land was worth. SVB mitigated this risk by requiring phased delivery and construction of the units – no more than three units could be under construction and in transit at any one time. Requiring that the units be delivered before extending more unsecured funds helped SVB get comfortable with the risk of lending unsecured and transporting the units from Oregon to Northern California. Overall, SVB was able to work with OCHI in structuring a loan draw-down schedule that both reduced risk for SVB and met OCHI’s financing needs.

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Stuck in the Middle

Financing Workforce Housing

By John Olson

There is a specific group of wage-earners who are caught between a rock and a hard place in the housing market in high cost areas. Earning too little to afford a home, they are relegated either to the rental market or to a crushing commute. Earning too much to be considered low- or moderate-income, they don't qualify for many programs that could help them buy their first home.

In the community and economic development field, "workforce housing" generally refers to units geared toward this group of earners falling between 80 and 120 percent of area median income (AMI). While housing these earners—typically teachers, nurses, and firefighters—in the communities where they work is an undisputed community need, financing the developments that would serve this market niche challenges some of our assumptions about what constitutes "affordable housing." Traditionally, community development activities have been geared toward those households earning less than 80 percent of AMI. But in high cost areas, the argument can be made that policies and resources—and perhaps even CRA consideration—should stretch to accommodate households earning as much as 150 percent of AMI, since they too have difficulty finding affordable housing options.

A number of jurisdictions with rising housing costs have established workforce housing initiatives that develop affordable housing and provide homebuyer assistance programs to this group. In addition, private investments around the country are beginning to fill the financing gap. In this article, highlighted are several new and unique California-based workforce housing funds aimed at addressing the housing needs of this group of earners. Though in various stages of formation, these funds have brought to the table a wide array of investors. Many financial institutions, which have traditionally been involved in community development, have invested in these funds, but other mission-driven investors such as insurance companies and pension funds have also acknowledged the importance of addressing this need and have made substantial investments.

Each of these funds tackles the "soft costs" of development. The cost of equity capital, in particular, can be crippling in

high cost areas. By providing affordably-priced equity, these funds aim to bring down the cost of development to the point at which the ultimate sales price is affordable to this segment of the workforce.

... in high cost areas, the argument can be made that policies and resources—and perhaps even CRA consideration—should stretch to accommodate households earning as much as 150 percent of AMI...

Genesis Workforce Housing Fund

The first of these funds to come into existence was the \$100 million Genesis Workforce Housing Fund. The Fund is a member of the Genesis LA Family of Funds, which focuses on a "double bottom line" to promote urban development and business growth in the greater Los Angeles area. The Fund provides equity capital to create for-sale and rental workforce housing. Debbie LaFranchi, who spearheaded the creation of the fund at Genesis LA, says that "the initial idea for this fund came from consistent reports of a crisis in housing for nurses, teachers, and police officers who couldn't afford to live in the communities where their jobs were located. The high cost of housing in these areas was hurting economic development efforts because of its impact on the workforce."

The fund focuses on families earning 80-150 percent of AMI, and in some cases, can go as high 200 percent of the median. The Fund's geographic focus is on low- and moderate-income (LMI) communities, and, to date, the fund's investments have all been in LMI census tracts.

Work on the fund started some four years ago, with extensive analysis of the feasibility of creating housing for people earning as little as 80 percent of the area median.

The analysis showed that it would be extremely difficult to develop affordable housing even for families earning 120 percent of the median without adding some form of (already scarce) public subsidy or allowing flexibility for some units in a development to go up to 150, and in some cases, 200 percent of AMI.

LaFranchi reports that the Genesis Workforce Housing Fund is capitalized at \$102 million. Phoenix Realty Group is currently reviewing a pipeline of projects in urban areas of Los Angeles, of which the Puerta Del Sol Condominiums was the first to break ground in June 2004.

CCRC Workforce Housing Fund

The California Community Reinvestment Corporation (CCRC) is a nonprofit multibank lending consortium founded in 1989 to address the shortage of quality affordable housing in California. CCRC is funded by more than 40 member financial institutions. While continuing to offer its traditional affordable housing products, CCRC created its workforce housing fund this year to address the jobs-housing imbalance in California. Mary Kaiser, CCRC's President, reports that her fund will close in early September with a capitalization of \$24 million, and will be focused on serving families earning between 80 and 120 percent of AMI. In some cases, the fund will be able to finance developments that include units affordable to those earning below 80 percent of AMI. According to Kaiser, the fund's mission is to "focus on people who have been priced out of the home market. CCRC's focus on finding gaps in the housing financing structure has shown there's a significant amount of work that needs to be done to meet the housing needs of people in this income range."

The fund attracted the attention of Dan Sheehy at Impact Community Capital LLC. (For more on Impact and how it structures and manages community investments for its investors, visit <http://www.impactcapital.net/>.) "For Impact and the insurance industry investors we represent, [CCRC's] workforce housing fund represented a unique opportunity to address the housing needs of working families and individuals who otherwise would be left behind in these escalating housing markets," says Sheehy.

CCRC's fund has a multifaceted focus on for-sale and rental housing, as well as special needs housing for seniors. The fund will operate throughout the state of California, and will focus on condominium development in particularly high cost areas.

Bay Area Workforce Housing Equity Fund

The Development Fund has partnered with A.F. Evans Company to create the Bay Area Workforce Housing Equity Fund, which is focused on providing high-quality single-family housing to working families in the San Francisco Bay Area. The Development Fund, founded in 1963, has a long history of facilitating the creation of multibank affordable housing consortia throughout the country. Sid Johnston, the Development Fund's Executive Director, said that the Bay Area was a natural place to tackle the "next thing" – the thorny issues around workforce housing: "In some parts of the Bay Area, you have to earn more than 200 percent of the median just to afford the median-priced home. The Bay Area is suffering from the highest income gap in the state of California."

"... there's a significant amount of work that needs to be done to meet the housing needs of people in [the 80-120 percent AMI] income range."

The fund will be targeting urban infill locations where no housing has existed previously, with a special emphasis on low- and moderate-income geographies. The fund has received commitments from several financial institution investors, and has a goal of closing the fund in the 3rd quarter 2005 with a capitalization of \$25 – \$50 million. Johnston reports that "the final size of our fund will depend in large part on how the CRA question turns out. Some of our potential investors have told us that they want a clearer ruling on how investments in these funds will be treated." (Box 5.2: Workforce Housing and the CRA).

An architectural elevation of the Puerta Del Sol Condominiums financed through the Genesis Workforce Housing Fund.



San Diego Smart Growth Fund

The San Diego Capital Collaborative was created by the San Diego City-County Reinvestment Task Force to address the need for a fund focused on the unique needs of San Diego County. Barry J. Schultz, the CEO of the collaborative, said that “the Smart Growth Fund is the only entity of its kind in San Diego County, and we’re in a position to leverage our equity to provide over \$500 million of residential and commercial development.”

The Collaborative created the San Diego Smart Growth Fund to address the need for workforce housing in the extremely high-cost San Diego market. The fund focuses on the “double bottom line” of financial and social returns for its investors and communities. Each potential investment is rated on how well it meets both bottom lines. In conjunction with the Phoenix Realty Group, the fund successfully raised \$60 million from CalPERS, the California Public Employees Retirement System, and will make its first investment in the third quarter of 2005.

The fund’s primary focus is the development of for-sale workforce housing, but also will support rental, mixed use, and commercial properties. Focusing on LMI geographies in San Diego County, the fund will target families earning between 80 and 200 percent of AMI. Schultz says that “the key factor in the fund’s strategy is to work with local LMI communities, and bring the fund’s resources to bear to help them fulfill their plans for the revitalization of their communities. We’re in the process now of collecting baseline data on these neighborhoods so we can measure the impact of our investments.”

The funds described here have a mission of targeting a seemingly intractable problem. Public subsidy is mostly targeted to those for whom housing is most out of reach. The market for housing in high cost areas prices out all but the wealthiest potential homebuyers. For those workers stuck in the middle, the properties developed by these funds offer hope that the dream of homeownership will be accessible.

But these funds also confront the industry with a controversial question of what policy changes should be made to

account for the market in high cost areas. Some argue that limiting affordable housing programs to those earning less than 80 percent of the median gives the community development field an appropriate focus on those most in need. Thus, guidelines should not be bent, even in high cost areas. Others would argue that the housing market in high cost areas shuts out a broader segment of the population than is traditionally considered needy, and that some flexibility must be employed in allocating community development resources.

Whether or not this policy issue is resolved in the near term, the funds described in this article are in the meantime providing at least one avenue for addressing a community need that has been left behind. ■

For more information on these workforce housing funds, please contact the following individuals:

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Workforce Housing and the CRA

Box 5.2

Workforce housing is a relatively new area of Community Reinvestment Act (CRA) policy. The *Interagency Questions and Answers* (Q&A) state that “the flexibility of the performance standards allows examiners to account in their evaluations for conditions in high-cost areas.” The Q&A specifically mentions an example of a CRA-eligible community development activity that funds affordable housing for middle-income individuals as well as low- and moderate-income (LMI) individuals. Certain workforce housing activities in LMI areas may also be considered to revitalize and stabilize those areas. Because there is not extensive precedent in this area, bank investors are encouraged to work carefully with their primary regulators to ensure that the bank and the examiners have the same understanding of how these funds will be considered.

A discussion of affordable housing is incomplete without considering the importance to many community builders of creating sustainable communities. While there can often be a disconnect between real estate development and environmental concerns, the 12th District is home to a number of exciting affordable housing developments that illustrate the possibility of integrating social and environmental justice through "green" building techniques and transit-oriented development. Green building offers a means to lower operating costs of a development and contributes to the health of both tenants and the environment, and transit-oriented development allows community members to access resources and amenities in a manner that contributes to both affordability and environmental protection.

Green Building

The Plaza Apartments, located near downtown San Francisco and expected to open in November 2005, will offer 106 single room occupancy (SRO) units affordable to tenants earning between 13 and 42 percent of area median income (AMI). In addition to redeveloping an underutilized urban site, the building will incorporate a number of environmentally conscious elements, including energy efficient appliances, recycled and recyclable building materials, enhanced natural lighting and ventilation design, and solar panels. SRO units, which in the Plaza will have full baths and kitchenettes with full-size refrigerators and two-burner stoves, are an important means to increase the density of affordable units built on limited land resources.

This development is one of the projects that received financing assistance through the Green Communities Initiative, a five-year, \$555 million initiative to build more than 8,500 environmentally-friendly housing units nationwide for low-income families. This initiative, launched in October of 2004, was created by the Enterprise Foundation / Enterprise Social Investment Corporation in partnership with the Natural Resources Defense Council. The program is funding projects through grants, loans, and equity and will also provide training and technical assistance to developers. Greening affordable housing is thus a way to leverage financing and resources otherwise unavailable to conventional affordable housing projects. In addition to the Plaza, Green Communities projects are currently in development in Portland, OR, Seattle, WA, New York, NY and Alamogordo, NM.

Transit-Oriented Development

Housing developments lose elements of both affordability and "green-ness" if sited in locations that don't offer walkable or mass transit-based access to jobs, grocery stores, daycare, and educational services. Transit-oriented development (TOD), which densely sites housing units and commercial offerings near transit centers, offers a means to address concerns about sprawl, the problems caused by having too many cars on the road, and geographic mismatches between housing and urban amenities.

A recently completed and lauded example of TOD is the Fruitvale Transit Village, located in Oakland, California. Developed by The Unity Council, a non-profit community development corporation working for economic, social, and physical development in the Fruitvale neighborhood, the project includes shops, community service agencies, offices, housing, and a community plaza, all centered around a Bay Area Rapid Transit station. This first phase of development includes a small number of units affordable to renters earning between 35 and 80 percent of AMI, and the Unity Council intends to add 250 units of housing to the Fruitvale neighborhood over the next five years as part of the overall Transit Village development. Fruitvale Transit Village represents an exciting effort to revitalize a community with sustainability and accessibility as central components of project design and execution.

For more information on these projects, see:

<http://www.enterprisefoundation.org/resources/green/index.asp>
<http://www.unitycouncil.org/transitvillage.html>

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Adjusting Limits to Account for High Costs Areas (Box 1.1)

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North Beach Place (Box 1.2)

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Not just your granny's flat (Box 3.1)

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Figures

Figures 1.1 & 1.2: JCHS tabulations of the 2000 Census Supplemental Survey and the 2003 American Community Survey. Reprinted from *The State of the Nation's Housing 2005* with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

Figure 1.3: Office of Federal Housing Enterprise Oversight (OFHEO). "U.S. House Prices Continue to Rise Rapidly," June 1, 2005. Data are reported for period ending March 31st, 2005.

Figure 1.4: Federal Deposit Insurance Corporation, *2005 State Profiles*, accessible at <http://www.fdic.gov/bank/analytical/stateprofile/index.html>. Data are for December 2004 and reflect the average annual growth for the preceding year. Washington data are for September 2004.

Figure 1.5: HUD's Fair Market Rents for 2004, based on methodology developed by the National Low Income Housing Coalition. Adapted from *The State of the Nation's Housing 2005* with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

Figure 1.6: U.S. Department of Housing and Urban Development, Low Income Housing Tax Credit Database.

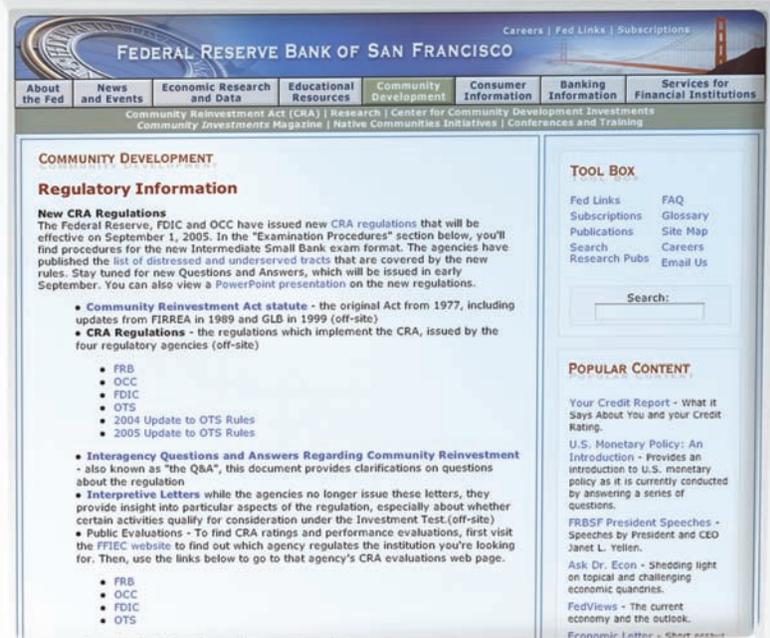
Figure 3.1: Center for Community Change (2005) www.communitychange.org

New CRA Regulations

The Federal Reserve, FDIC, and OCC have issued new CRA regulations that will be effective on September 1, 2005.

The new rules:

- Create a new category of banks, Intermediate Small Banks, for institutions with between \$250 million and \$1 billion in assets.
- Relieve Intermediate Small Banks from data reporting requirements.
- Establish a new CRA exam format for Intermediate Small Banks that includes two equally weighted tests: a Lending Test, modeled on the small bank exam, and a new, flexible Community Development Test.
- Expand the definition of Community Development for all banks to include disaster areas and distressed or under-served rural areas.
- Lists the violations of fair lending laws that could impact a bank's CRA evaluation.



Visit <http://www.frbsf.org/community/craresources/info.html> for links to:

- The new regulations
- The new Intermediate Small Bank exam procedures
- The new *Questions and Answers*
- A short powerpoint overview of the new regulations

The artwork featured on the front cover, entitled "Tenderloin Street Scene," is by Charles Blackwell, a participant in the Community Arts Program of Central City Hospitality House (CCHH), a community center serving homeless and low-income individuals in the Tenderloin neighborhood of San Francisco. The Community Arts Program provides free-of-charge materials and space for homeless, formerly homeless, poor, and at-risk artists to create, house, exhibit, and sell their work. CCHH, which works to build community strength by advocating for policies and rendering services that foster self-sufficiency and cultural enrichment, also offers assistance through the Tenderloin Self-Help Center, the Employment Program, and the Shelter/Case Management Program. Please visit www.hospitalityhouse.org or contact Jackie Jenks, Executive Director, at 415.749.2133 for more information about any of CCHH's programs.



Mr. Blackwell, who is visually impaired, is shown at work on another piece in the Community Arts studio.

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