Time for Local Governments to Get Assistance… and a Breather

Housing and Land Use: What's to be Expected in the 2021 Legislative Session

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When anticipating housing and land use legislation in California's 2021 legislative session, a scene from the 1942 movie Casablanca is applicable to the role of local governments recently in the State Capitol. With the plane about to take off, the inspector chooses to ignore what he just witnessed and says decisively: "Round up the usual suspects!" Such has been the plight of local governments in recent state housing policy discussions.

Local government planning and land use is often easier for legislators to focus on than grappling with the realities of private markets; allocating major funding for subsidized housing; challenging developers, labor, environmental and other powerful interest groups and addressing the state's own policy failings. While local governments certainly have a responsibility to set the table and streamline local approval processes, it's arguable that much of this has already been addressed by layers of state laws--including many recently approved laws that locals are still trying to implement. But with the Legislature's return weeks away, and some bills already introduced, this paper--after first providing background on some other issues affecting housing production--will focus on what local governments can expect in 2021.

Local governments also enter the new year facing tremendous economic difficulties. Unlike the state, which began 2020 with a projected $20.5 billion in reserves and soaring income tax and capital gains generating $6 billion in surplus projections, many local governments were still struggling from the Great Recession. Local revenue growth and staffing levels were slow to recover, compounded by increased pension contributions to offset financial losses at CalPERS [1]. In short, when COVID hit, local governments were in a weaker financial position then the state to absorb the impact. It will likely be years before many local economies recover. The pandemic has made things worse. Revenues are down; costs are up. Once-vibrant downtowns are hollowed out, and small businesses that remain are barely hanging on.

Thus, in 2021, the Legislature should recognize the many challenges faced by local governments struggling to cope with economic hardships imposed by the pandemic, compounded by the burden of implementing recently passed laws. In short, 2021 should be a time to give local governments a breather from more laws and allocate some of the recently identified budget "windfall" for local economic and recovery and more funding to build affordable units.

[1] California Public Employees Retirement System

Issues Affecting Housing Production

The applicable economic principle for housing production is “the elasticity of supply,” meaning that more of a good (or product) will be produced when prices rise, and less when they fall. This concept, however, appears at odds with the prevalent assumption in some state housing policy discussions. The preoccupation with local planning and increasing allocations of Regional Housing Needs Assessment (RHNA) units is based upon the theory that increased zoning will result in increased housing production regardless of market conditions. This theory, however, does not take sufficiently into account other issues [2] that influence what actually gets built, including the following:

- **Market Influences**: Housing production largely reflects economic conditions and individual choice. Individuals are free to choose where they live or work. Developers decide what types of products to propose. It is a free market reflecting a multitude of individual decisions. Market demand, in turn, affects prices and what is built. For example, over the last decade well-compensated technology employees escalated home prices and rents in the Bay Area, especially in those communities and neighborhoods that offered the most amenities and quality of life. Individuals preferring a more rural lifestyle seek homes built on larger parcels outside urban areas; those seeking urban amenities close to work want to live in vibrant city centers. Growing families migrate to homes with backyards and quality schools. Market developers identify and anticipate these and other market signals and respond accordingly. The last thing a developer wants to do is build units that will not sell or rent for a profit.

- **Subsidized Housing:** The biggest housing policy challenge has always been about meeting the housing needs for extremely low-, very low- and low-income households. Building units and maintaining affordability for these households require significant public subsidies, but resources for publicly-funded housing has been declining for decades. A recent report from the State Auditor summarizes the gaps between affordable housing demand and production. They estimate statewide need for 125,000 units annually while resources are available to only produce 19,000. [3] Contributing factors to the lack of affordable housing include:
    - Federal funding for constructing affordable housing has dramatically declined since the early 1980s. In addition, many former affordable developments built with federal funding are continuing to convert to market rate housing.. [4]

[2] Federal, state and local policies can influence housing markets, but actual production levels also reflect deeper economic currents, consumer preferences, employment levels and the available of public subsidies. Federal policies influencing housing development include supporting a secondary market for mortgages, HUD and Veteran's Loan programs, income tax policy and investing in highways and transit systems that open up more locations housing development. State policies include building, fire, and disabled access codes, energy requirements, environmental policies and labor requirements. Local government policies include land use plans and zoning and providing infrastructure and services to support housing residents.

[3] The Auditor's report levies some significant critiques on state activities related to housing in Part 1 of the report, and more criticism of local government in Part 2. One omission is that nowhere in this 70-page report is there any recognition of the state's elimination of redevelopment.

[4] 1n 2016 the California Housing Partnership estimated that there were 133,359 units that were at risk of converting to market rates over 10 years (p. 31, Department of Housing and Community Development's 2025 Statewide Housing Assessment).

- The 1986 Federal Tax Reform Act had major implications on the development of rental units; the Act eliminated prior generous depreciation tax benefits for investors, which contributed to a decline in production, as documented in national and statewide building permit data.
- Federal affordable housing tax credits were created to replace the incentives removed by the 1986 Tax Reform Act, but they are limited compared to demand, with a complex application processes restricting access to only the most sophisticated investors. State housing tax credit contributions have historically been very minor, around $70 million per year, but on a positive note, were recently increased to $500 million annually.
- State funding for affordable housing has typically been very limited. The primary source of funding has been general obligation bonds, averaging $3-$4 billion, approved about once per decade. Several hundred million annually also come from Cap-and-Trade proceeds. Governor Newsom's 2019 budget, however, was a major departure from this trend, since over $1 billion were allocated in one-time General Funds.
- Local redevelopment agencies, prior to state elimination in 2011, were the largest source of affordable housing funding in the state, generating over $1 billion per year. [5] These agencies also had resources to repair and upgrade infrastructure and support transit-oriented development. The tools adopted to replace them are so weak that many communities see little value in using them. The continued absence of local tools will frustrate the achievement of the state's density and greenhouse gas reduction goals.

- **Local Infrastructure and Service Challenges**: Local governments face additional challenges providing infrastructure and services for affordable housing, including:
  - Local special taxes or general obligation bonds that could pay to upgrade infrastructure require a two-thirds public vote. Proposition 13 of 1978 imposed caps on local property taxes. These hurdles are difficult to overcome. Thus, infrastructure for new development must rely on development fees to offset costs. But such fees are insufficient to address preexisting deteriorated infrastructure conditions, which redevelopment used to help with. [6]
  - Revenue from housing (property tax, sales tax, etc.) generated by residents often fails to offset service costs. This problem is compounded for multi-family developments and for affordable housing developments for which the state provides property tax exemptions. [7]

[5] *Failing to mention redevelopment in recent state housing reports is not unusual. The February 20, 2019 report on local government planning for housing by the Legislative Analyst and the 140-page Department of Housing and Community Development's 2025 Statewide Housing Assessment, released in 2018, do not focus on the role redevelopment once played in affordable housing.*

[6] *Compare this to state general obligation bonds which can pass with a simple majority, and the state's ability to raise taxes with a two-thirds vote of the Legislature and Governor's signature. ACA 1 (Aguiar-Curry), which would lower local voting thresholds to 55%, would be helpful.*

[7] *Local governments approving higher-density housing and affordable housing should receive a reliable ongoing state per-unit stipend to ensure locals can provide services.*

- **Impact of Other State Policy Choices on Affordable Housing Cost:** Affordable housing developers often mention the impact of state environmental, energy, labor and other policies that increase the per-unit subsidy costs for affordable housing units. All of these policies have their rationale, yet such policies do also affect the cost of affordable units. [8]

- **Housing Element's Limitations:** Back in 2003, the Public Policy Institute of California, a highly reputable policy research entity, produced a report that created a political dust storm among housing policy advocates when it questioned the nexus between state-approved housing elements and housing production. A press release announcing the PPIC study concluded:
  - "'The law requires cities and counties to plan for specific numbers of new housing units, including affordable housing, but provides no direct resources to get the housing built.… The housing element law asks local governments to identify sites for housing and to adopt measures to encourage new construction, but it pretty much stops there,' says Paul Lewis, the study's author and PPIC program director and research fellow. 'Planning does not necessarily translate into housing.' Ultimately, decisions about where, when, and what kind of housing is built are made by private and nonprofit homebuilders, Lewis notes."

  Despite questions about the effectiveness of housing elements on actual production, and with over 97% of local housing elements already deemed in compliance by HCD [9], the state has continued to push forward adding more requirements to the housing element process. Most recently, the state doubled down on this assumption with massive increased allocations of regional housing needs allocations in the sixth RHNA cycle. The recent Auditor's report is now suggesting penalties and sanctions for local governments when certain production levels are not achieved. A multi-billion-dollar state annual funding commitment to build affordable units would yield a better result.

- **Many Other Laws on the Books**: Besides housing elements, the state has passed many laws to address concerns with local housing and land use approvals. Section 65582.1 of the Government Code details a long list of them, with applicable code sections:
  - Extension of statute of limitations in actions challenging the housing element
  - Restrictions on disapproval of housing developments
  - Priority for affordable housing in the allocation of water and sewer hookups
  - Least cost zoning law
  - Density bonus law
  - Accessory dwelling units
  - By-right housing, in which certain multifamily housing is designated a permitted use
  - No-net-loss-in-zoning density law limiting down-zonings and density reductions
  - Requiring persons who sue to halt affordable housing to pay attorney's fees
  - Reduced time for action on affordable housing applications

[8]The State Auditor's report did not delve into these issues.
[9] Department of Housing's Updated Housing Element Compliance report dated November 15, 2020.

- Limiting moratoriums on multifamily housing
- Prohibiting discrimination against affordable housing
- California Fair Employment and Housing Act
- Community redevelopment law [10]
- Streamlining housing approvals during a housing shortage
- Housing sustainability districts
- Streamlining agricultural employee housing development approvals

Collectively, these laws impose significant sanctions and limitations on an array of potential local actions and severely limit local ability to deny affordable developments. Local government's good faith on housing issues is also demonstrated by the 97% housing element approval rate by HCD after microscopic state reviews.

Eight Major Housing Questions for the 2021 Legislative Session

The prior summary of housing policy issues from a local perspective hopefully offered some background and a foundation from which to begin to consider legislation in the 2021 Session. Now it's time to look forward. The COVID-19 pandemic, changing state budget conditions, the new Biden-Harris administration and the expected return of many issues from the prior year promise a busy legislative session. Below is an outline of eight major questions affecting land use and housing in 2021:

(1) Will Local Governments or Affordable Housing Benefit from the State Budget "Windfall?"

The Department of Finance and the Legislative Analyst (LAO) are good at predicting state revenues, but last June--in the midst of the COVID pandemic-- they missed wildly, leading the Legislature to adopt a 2020-21 budget that anticipated a massive decline in revenues and contingent on a hoped-for $14 billion federal bailout. The cuts the Legislature adopted included rolling back $703 million in previously allocated state affordable housing funding. [11] In November 2020, however, the LAO announced that – thanks largely to taxes on income and capital gains from a rising stock market on higher income households -- there was a $26 billion unanticipated "windfall" in the existing FY 2020-21 budget. Whatever the number, the question remains whether the Legislature and Governor will use some of the "windfall" and potential additional federal "relief" anticipated from the new Biden-Harris administration to assist local agencies and provide affordable housing and homeless funding.

(2) Will Other Funding Possibilities be Approved for Local Governments and Affordable Housing?

Three bills have been introduced that bear watching for their potential to provide additional resources to local governments and affordable housing:

[10] While this statute was amended in 2019, the Legislature has yet to eliminate this reference to previous redevelopment law.
[11] AB 89, Budget Trailer Bill, reverted to the General Fund $703 million of affordable housing funding that was previously appropriated in prior budgets. The legislation provided for the restoration of up to $45 million for moderate-income housing and $203 million in infill infrastructure grants if additional federal funds are made available.

a. **AB 71 (Rivas/Chiu)** States legislative intent to create a comprehensive, statewide homelessness solutions program with ongoing funding, to be paid for by increasing taxes and closing loopholes on higher income individuals and corporations.
b. **ACA 1 (Aguiar-Curry)** Lowers the vote threshold from two-thirds to 55% for a local government general obligation bond, sales tax or transactions and uses tax increase for the purposes of funding the construction, rehabilitation, or replacement of public infrastructure, affordable housing or permanent supportive housing.
c. **SB 5 (Atkins)** Spot bill for Affordable Housing Bond for the November 2022 ballot.

(3) What Happens to COVID-Impacted Renters Facing Eviction and Landlords?
Before the Legislature adjourned in September, a temporary agreement was forged between the Governor, legislators, housing advocates and rental property owners to pass AB 3088 (Chiu), which temporarily extended by four months an eviction moratorium for non-payment of rent to expire on January 31, 2021. [12] Up to 2 million tenants are potentially impacted. This will be a very difficult and costly problem to solve. The financial liability to landlords was estimated by the Franchise Tax Board to potentially be $1.4 billion per month, which could tally over $10 billion in unpaid rent.

With California in the midst of a wave of COVID infections, how the Legislature will bridge this massive problem is unknown. Assemblymember Chiu has introduced AB 15, proposing to extend the moratorium to January 1, 2022, and AB 16 as a vehicle to mitigate fiscal impacts. Senators Caballero and Bradford introduced SB 3, which would extend the moratorium by two months. Beyond the plight of tenants, the resolution of this issue will also bear heavily on the willingness of future investors to build and operate rental units in California.

(4) Will Major Changes Occur to Single-Family Neighborhoods?
On the last night of the 2020 Session, SB 1120 (Atkins) stalled on the Senate Floor before it could be taken up. It proposed to preempt all local single-family zoning by allowing two homes to be built on any single-family lot, and for property owners to split single-family lots, creating lots as small as 1,200 square feet with four-foot setbacks in back and side yards. SB 1120 moved through the Legislature last year in a legislative process that was short on transparency given the many COVID-19 limitations, and, despite its likely massive impact on millions of single-family homeowners, it was not adequately covered by the press. This bill has now been reintroduced as SB 9 (Atkins) and deserves broader consideration of its potential impacts.

(5) Which Cities and Counties Will Be on HCD's "Prohousing" List?
A provision included in AB 101, the 2019 Housing Budget Trailer bill, empowered the Department of Housing and Community Development (HCD) to establish a list of "prohousing" communities. Communities that end up on this list (See Section 65589.9 Government Code) are entitled to priority access to various pots of state funding. Rather than requesting HCD to come up with a draft list of communities for legislative review,

[12] *Tenants suffering a COVID-19 rental hardship must pay at least 25% of owed rent.*

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the Legislature passed the entire process to the discretion of the Department. HCD is required to produce this list by July 1, 2021.

(6) Which Recommendations from State Auditor's Report Will be Pursued?
The State Auditor's office weighed in on housing issues with a 70-page report [13] issued in November. AB 68 (Salas) was introduced as a spot bill to implement them. The report has essentially two parts:

a. Levies criticism on the state, including for squandering affordable housing financing resources and not having a coordinated housing plan than includes realistic expectations for the number of affordable housing units that can be produced annually.
b. Criticizes local governments on a variety of fronts, proposes a state-level appeals board for local housing decisions and suggests penalties and withholding funding if certain production thresholds are not achieved.

(7) What Happens to Continued Focus on Local Development Impact Fees?
Local development impact fees are required by law to meet a "nexus" test to ensure that they do not exceed the proportional impact of a proposed development on infrastructure and local services. Such fees are necessary to offset the impacts of new development, especially given limitations on new local revenues. These development impact fees have been the focus of HCD analysis and state legislation in recent years out of a concern about their effects on housing affordability. Assemblymember Grayson and David Chiu have each introduced bills on this topic in recent years, and more are expected in 2021. AB 59 (Gabriel) was introduced on this topic on Dec. 7.

While it is argued that reducing fees improves housing affordability, so far none of these policy discussions have proposed linking a reduction in fees to requirements for builders to proportionately reduce their market rents or sales prices. [14]

(8) Which Other Unfinished 2020 Housing Bills Will Return?
During the 2020 session, numerous high-profile land use and housing bills stalled, but many were reintroduced in Legislature's organizing session:

- **SB 6 (Caballero)** Facilitates the conversion of underutilized commercial properties to mixed use and affordable housing, while retaining some local control and input. Appears to be a reintroduction of SB 1385 (Caballero) from 2020.
- **SB 7 (Atkins)** Provides CEQA streamlining for affordable housing projects over $15 million. A reintroduction of SB 995 (Atkins) of 2020.
- **SB 8 (Skinner)** Proposes a variety of changes to Density Bonus Law. Some changes may replicate proposals included in SB 1085 Skinner of 2020.
- **SB 9 (Atkins)** Requires local governments to approve two housing units on a single-family lot and lot splits. Appears to be a reintroduction of SB 1120 (Atkins) of 2020.

[13] State Auditor's Report: California's Housing Agencies, November 2020.
[14] Historical note: when a similar argument was raised over school impact fees by homebuilders in 1998, the state capped fees, then backfilled school construction costs over the years with over $30 billion in state bonds, but that action does not appear to have had an impact on home prices. In Los Angeles County, between 1998 and 2020, the average single family home increased in value from $200K to $714K.

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- **SB 10 (Wiener)** Authorizes locals to waive local ordinances and voter-approved measures to zone for up to 10 units. Appears to be a reintroduction of SB 902 (Wiener) of 2020.
- **SB 15 (Portantino)** Requires HCD, upon appropriation, to offer annual grants for seven years to those local agencies that voluntarily convert idle big box and commercial shopping sites to workforce housing. Appears to be a reintroduction of SB 1299 (Portantino) of 2020.

Next Steps: Legislators will return to the Capitol on Jan. 4, 2021, to begin another year. Activity will begin quickly. The Governor is required to submit his draft budget by Jan. 10, and all bills must be introduced by Feb.19. Advocacy by stakeholders will again be challenging. Health and safety protocols arising from the COVID pandemic will continue to alter the traditional legislative hearing process, and limit access legislators and staff. Local government agencies concerned about land use and housing should monitor the process closely and engage where necessary to ensure your voice is heard. It's going to be a busy year!

<u>**About Dan Carrigg:**</u>

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