

General Obligation Bond for Affordable Housing: Economic Impact Report

Office of Economic Analysis
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Introduction

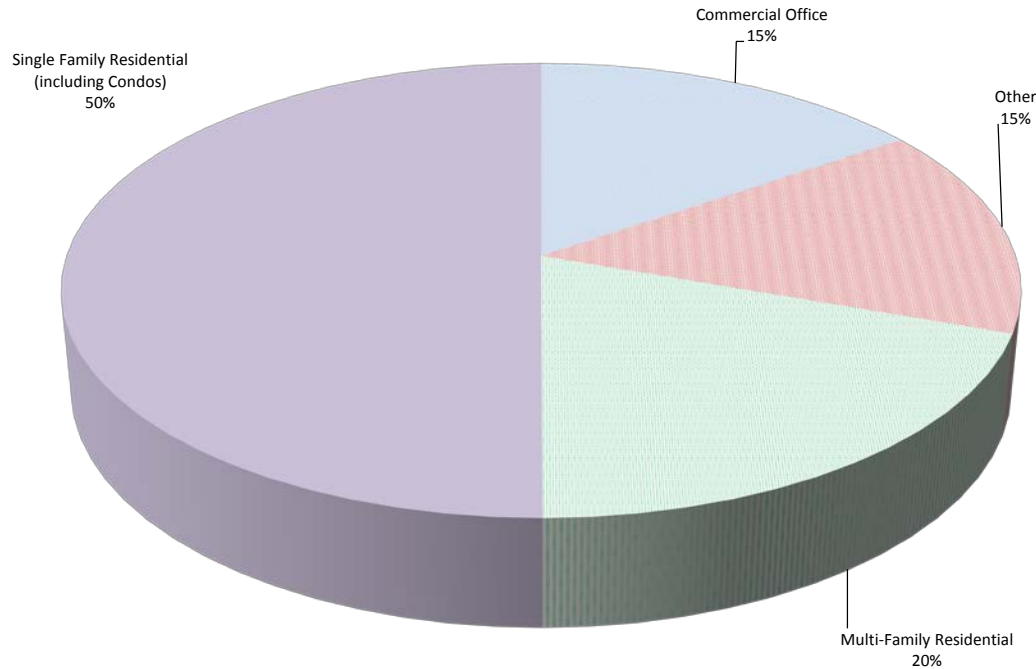
- On May 12, 2015, both Mayor Lee and Supervisor Avalos introduced different motions to place a General Obligation bond for affordable housing on the November, 2015 ballot.
- General obligation (GO) bonds are debt instruments issued by the City, and secured with the General Fund. They must be approved by the voters with a two-thirds majority.
- Both proposed GO bonds are proposed to fund various affordable housing programs in the City.
- On June 22, 2015, the two proposals were combined into a single, \$310 million package.
- The Office of Economic Analysis (OEA) has prepared this report because the single proposal could have a material economic impact on the city, if it were enacted by the voters.

Housing Affordability in San Francisco

- According to data from Zillow, the median value of a owner-occupied dwelling in San Francisco currently exceeds one million dollars.
- While the majority of San Francisco households rent their homes, and the vast majority of San Francisco apartments are subject to rent control, these units revert to market rent upon vacancy. Accordingly, many tenants face high rent burdens, which have increased rapidly in recent years.
- According to the American Communities Survey, in 2013 95,000 San Francisco households have at least one adult in the labor force, rent their home, and earn 80% or less of the area median income. These households spend an average of 46% of their income on housing.
- In addition, low income households in San Francisco are more than twice as likely to move out of the city than households with 80% of AMI or above. 12.3% of low income households move out each year, compared with 5.9% for those households with moderate income and above.

Assessed Value of Secured Property in San Francisco

Assessed Value in San Francisco by Property Use, 2014



GO Bonds are funded through a property tax rate surcharge. The cost therefore falls on property owners in the city, in proportion to the assessed value of their property.

As of 2014, residential property accounted for 70% of the assessed value in the city, so 70% of the cost of the proposed bond will fall on residential property and their tenants.

The proposal authorizes a pass-through of 50% of the tax increase from landlords to tenants, so tenants can be expected to bear approximately 10% of the cost of the debt.

Proposed Use of the Bond Proceeds

- According to the Mayor's Office, the \$310 million in expenditure will be distributed as follows:
 - \$100 million for rehabilitation and construction of affordable housing for low income households across the city.
 - \$50 million for affordable housing within the Mission district.
 - \$80 million for the rehabilitation of existing public housing units.
 - \$80 million for down-payment assistance and developer incentives targeting middle-income households.
- The proposal will fund housing programs focused on four policy areas:
 1. Construction, development, and rehabilitation of new affordable housing, either directly or through increased incentives to developers of market-rate housing.
 2. Rehabilitation of existing public housing units.
 3. Acquisition of existing rent-controlled apartment buildings, to make them permanently rent-controlled.
 4. Down-payment assistance to first-time homebuyers who are public school teachers or middle-income residents.

Economic Impact Factors

- Each of the four major types of policies mentioned on Page 5 involve similar types of costs and benefits.
- **Benefits of a Smaller Housing Burden on Low-income Households:** the stated goal of the GO bonds is to lessen the housing burden on low- and moderate income households. Policies can be evaluated based on their cost-effectiveness at this goal.
- **Indirect Price Effect:** Some policies would also reduce the housing prices and rents facing low-income households in the private housing market, providing indirect benefits to low income households that do not directly receive a subsidized housing unit.
- **Economic Benefits of Construction:** Some of the policies would involve increased construction spending, which generates multiplier effects in the local economy.
- **Costs:** The City's capital planning policy states that new general obligation debt should not result in a higher property tax rate, and only increase to the extent that existing debt is retired. Nevertheless, new debt – including the principal and financing costs – does represent a cost to the city's property owners and tenants. According to the Office of Public Finance, current market interest rates for GO debt are approximately 3.3%.
- Quantifying many of these impacts is unusually challenging. Financing costs depend on future interest rates, which are uncertain. In addition, the unit costs of each program is also subject to uncertainty.

1. Constructing New Affordable Housing

- In constrained housing markets like San Francisco, the construction of new affordable housing is often seen to be the most cost-effective means of reducing the housing burden on low-income households.
- New affordable housing provides direct benefits to the household that receives it, indirect benefits to other low-income households by reducing demand in the private market, and construction multiplier effects for the local economy.
- An average low-income household paying 30% of its income in rent in an affordable unit, instead of the prevailing 46%, would receive a \$6,000 annual subsidy.
- We estimate that the indirect price effect benefitting all low-income households seeking new rental housing in the private market would be larger—about \$9,000 per year per unit.
- While the benefits of new affordable housing are large, the costs can also high on a per-household basis as well. In addition to construction and ongoing maintenance costs, land acquisition costs can be substantial.
- We calculate the net present value of the direct and indirect benefits of a new permanently affordable unit to be approximately \$400,000, using a 5% discount rate. According to the Mayor's Office of Housing (MOH), the City's cost per unit is approximately \$200,000. The benefits to low-income households therefore exceed the City's costs, by a wide margin.

2. Rehabilitating Public Housing

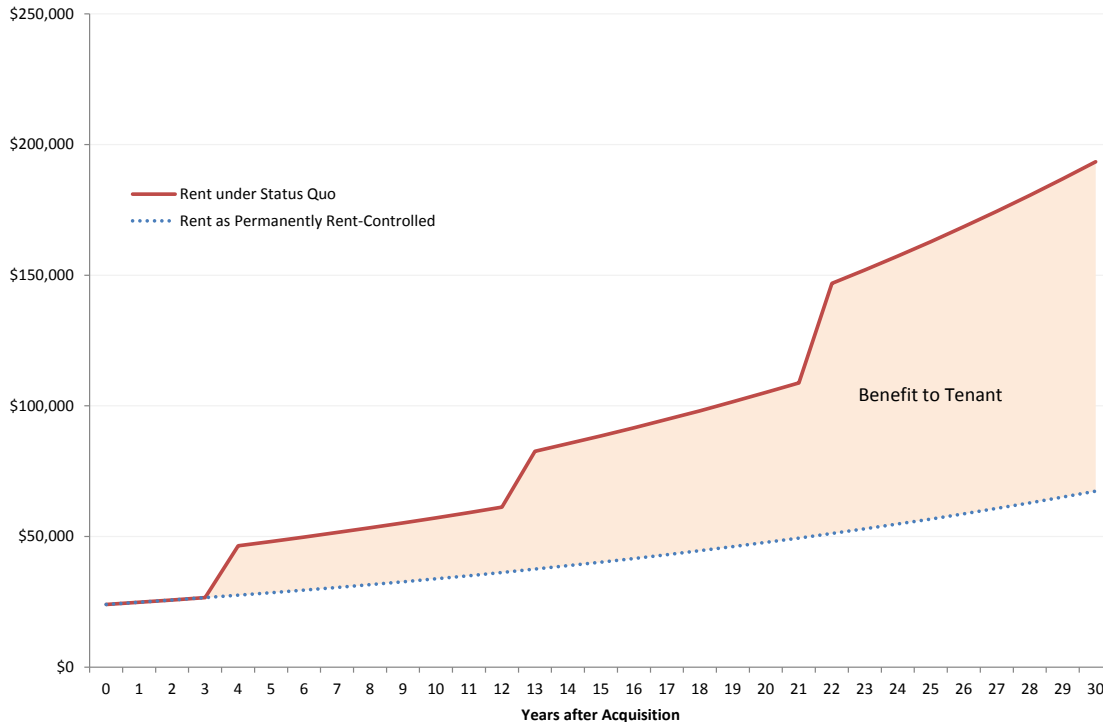
- The \$80 million in bond proceeds for public housing is focused on accelerating the HOPE SF program.
- HOPE SF aims to rebuild San Francisco Housing Authority sites, which have deteriorated in quality, into mixed-income communities featuring renovated public housing units, market rate housing, and new permanently-affordable housing.
- Given their poor condition, rehabilitation is likely to maintain the usable life of many units, and thus is effectively increasing the supply of permanently affordable housing in the future. It is therefore likely to provide some kind of indirect as well as direct affordability benefit, but these benefits, and the cost per unit, are difficult to quantify.
- Without quantifying the cost and future benefits to affordability and livability, the economic impact of investing in rehabilitating public housing is positive simply because of the economic benefit the construction spending exceeds the economic costs of the debt service.
- At current interest rates, assuming a 20 year loan, the planned investment in public housing will increase net spending in the local economy by \$38 million, and have a net employment effect of 44 jobs per year for 20 years.

3. Preserving Existing Rental Housing: Policy Background

- MOH also manages a Small Sites program, which funds the purchase of existing rent-controlled apartment buildings, in order to keep them permanently rent-controlled.
- The bond program's investment in preserving existing rental housing would likely expand the funding for this program.
- Rent control in San Francisco applies to rental housing units built prior to 1979, and regulates the allowable annual increases in rent of occupied units. The rent of vacant units, however, is unregulated.
- The gap between the controlled rent of an occupied unit, and the market rent of a vacant unit, can create an incentive to evict or buy-out tenants in order to raise rents. Reducing this incentive is among the stated objectives of the program.
- Another benefit, which is easier to quantify, is the reduced rents that future tenants will receive, because a unit's rent will never reset to market rent upon vacancy. Under the Small Sites program as presently constituted, a unit's rent may never increase by more than 3.5% per year. Market rents in San Francisco have increased at over between 6-7% annually, on average.

Benefits of Acquisition/Preservation of Existing Rental Housing

Annual Benefits of Acquiring One Unit of Rent Controlled Housing and Making It Permanently Rent-Controlled



The chart to the left indicates the annual benefits to tenants, over a 30 year period, of making a rent-controlled housing unit permanently rent-controlled. In this example, the unit become vacant in year 4, and then again every 9 years – the current average tenancy in rent-controlled apartments in the city.

When it becomes vacant, its rent rises to the market level, calculated from historic trends in market rent growth off the initial rent in year 0. Until that vacancy event, it rises the much lower trend in rent-controlled rent.

The chart illustrates that the benefits are largely in the future. In the earliest years, tenants are already benefitting from rent control..

In addition, unlike new affordable housing and public housing rehabilitation, this program will not alter the supply of or demand for housing, and hence has no indirect benefit.



Benefit-Cost Ratio of Preserving Rent-Controlled Housing

- According to our financial model of the program, if the prices of properties acquired under the program reflect their future rental income, as would be expected, then the policy's Benefit-Cost ratio should not be sensitive to future growth in rents and operating expenses.
- If the market expects future rent increases to be large, then it will be expensive for MOH to acquire property. However, future tenants will receive a large subsidy. Conversely, if the market expects rents under the program to more closely track market rents, future subsidies will be lower, but MOH's acquisition costs should be lower as well.
- For this reason, in our financial model, only the bond interest rate and the discount rate affect the benefit-cost ratio. The higher the debt service costs, the lower the benefit-cost ratio; the more the market discounts future income, the lower MOH's acquisition costs, and the higher the benefit-cost ratio.
- At current interest rates and assuming a 5% discount rate, the program would generate \$1.12 in subsidy per dollar in expense. This would make the program a relatively cost-effective form of subsidy for affordable housing. In all likelihood, however, it would be significantly less cost-effective than producing new affordable housing.

4. Down Payment Assistance

- As discussed earlier, the bond proceeds would also fund two down payment assistance programs targeting middle-income households purchasing their first home.
- The first, Down Payment Assistance Loan Program (DALP) provides an interest-free loan, up to \$57,000, that converts to equity upon the re-sale of the house. The loan can prevent a first-time homeowner from needing private mortgage insurance, which can carry a high effective interest rate.
- Upon resale, the program receives a share of the capital gains equal to its share of the initial equity invested. For example, if DALP contributes 5% of the purchase price, and the owner puts 15% down, then upon resale, the City is entitled to 25%, or $5\% / (5\% + 15\%)$ of the profit.
- Because of this debt-to-equity feature, and San Francisco's generally rising home prices, the program is likely to be profitable for the City over the long run, making it very advantageous from a cost-benefit point of view.
- The second, the Teacher Next Door program, encourages public school teachers to live in San Francisco by assisting with a first-time down payment, up to \$20,000 even if their household income exceeds 120% of area median income. The loan is repayable only if the house is sold, or the teacher leaves the San Francisco Unified School District, within 10 years. After 10 years, the loan is forgiven. The loan is repayable, without interest, if the house is resold within five years.

Conclusions

- San Francisco's chronically high housing prices, and the high housing burden facing low-income households in the city, have made affordable housing investment a major policy priority in recent years.
- The proposed GO bond will significantly increase the resources that the City devotes to producing, acquiring, rehabilitating, and maintaining housing for low- and middle-income households in the city.
- The four major policy areas funded by the bond can be expected to offer a range of economic benefits:
 - New affordable housing generates both direct and indirect housing subsidies whose value greatly exceeds the City's per new unit.
 - Rehabilitating public housing produces similar benefits that are harder to quantify, but the economic benefits of the construction spending alone exceeds the costs.
 - Purchasing existing housing to make it permanently rent-controlled is also likely to generate subsidies that exceed the cost of acquisition, given current interest rates and a reasonable discount rate.
 - Down payment assistance, as the DALP program is currently structured, is likely to generate revenue for the City over the long term, as well as assist middle-income households purchase their first home.

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