



**Date:** April 25, 2001  
**To:** IRP Legislative Committee Members  
**From:** Staff  
**RE:** Analysis of the Proposed FY 01-02  
Budget for the State Housing and Community Development  
Department (HCD) by the Legislative Analyst's Office

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The proposed Housing and Community Development budget for FY 2001-02 includes number of programs that would affect the IRP. The items, and a summary of the Legislative Analyst's Office (LAO) analysis of the items, are below. The full text of the LAO review is attached.

**Incentive Grants:**

The 2001/2002 proposed budget includes an additional \$200 million be allocated to the existing Jobs/Housing Improvement Program. This program was created last year by the passage of AB 2864 (Torlakson, 2000). The existing program makes available \$100 million in incentive payments to local governments to increase housing, based on the level and type of permits issued by a jurisdiction in 2001. The Governor has proposed adding an additional \$200 million and making the payments based on permits issued 2001 and 2002.

The LAO states that the payments will fail to change the underlying disincentives to build more housing, and recommends "redirecting" the proposed funding, including the \$200 million proposed by the Governor, to a more effective approach to addressing the state's housing needs.

**Central Valley Infrastructure Grant Program:**

The proposed HCD budget includes \$20.2 million in funding for a new Central Valley Infrastructure Grant Program, proposed by the Governor. Grants of up to \$1 million would be given to no more than 25 projects that promote economic development, and are related to water and wastewater systems, utilities, streets, or communications.

The LAO recommends deleting the funding for this program because it presumes that local governments in the Central Valley can't fund their own improvements, other programs already offer assistance of this sort, and it is unclear why other rural governments outside the Valley have been excluded.

**Requested Action**

Staff recommends that the IRP request a \$25 million earmark from the \$200 million in additional funding the Governor has proposed for **Incentive Grants**, to fund opportunity zone incentives that are part of the existing IRP Pilot Program.



# Analysis of the 2001-02 Budget Bill

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## Housing and Community Development (2240)

The mission of the Department of Housing and Community Development (HCD) is to help promote and expand housing opportunities for all Californians. As part of this mission, the department is responsible for implementing and enforcing building standards. The department also administers a variety of housing finance, economic development, and rehabilitation programs. In addition, the department provides policy advice and statewide guidance on housing issues.

The budget proposes expenditures of \$531 million for 2001-02. This is a 6 percent increase from estimated current-year expenditures. The proposed General Fund expenditures of \$317 million account for 60 percent of the department's proposed funding. Included within this total is \$220 million for one-time spending on new proposals for expanding incentive payments to local governments and a new Central Valley infrastructure program. Federal funds account for \$107 million of the proposed budget-year expenditures, primarily for the Community Development Block Grant (CDBG) and Home Investment Partnership Act programs. A number of state special funds provide the remainder of HCD's funding. The department has a proposed staffing level of 497 personnel-years.

The department also received a large one-time appropriation for nearly \$500 million in the current year for a variety of programs. The budget proposes to expend these funds over 2000-01 and 2001-02. Below, we review the implementation of the current-year's housing funding package and analyze the Governor's new proposals.

### Implementation of the 2000-01 Housing Package

The *2000-01 Budget Act* included a substantial increase in the department's General Fund support, largely on a one-time basis. In addition to augmenting funding for existing programs, the budget and accompanying legislation also created a number of new department programs. Figure 1 summarizes the allocation of the more than \$500 million housing package, as well as the proposed spending in these programs in 2001-02. We discuss the status of the various programs below. Funding notices and applications should be available to eligible applicants for all of the programs by February 2001.

**Figure 1**

**HCD Funding for Major Housing Programs**

*General Fund  
1999-00 Through 2001-02  
(In Millions)*

	1999-00	2000-01 <sup>a</sup>	Proposed 2001-02
<b>Local Government Incentives</b>			
Jobs-Housing Balance Improvement Program:			
Incentive grants	--	\$100.0	\$200.0
Economic development grants	--	5.0	--
Mass transit predevelopment loans	--	5.0	--
<b>Homeownership</b>			
CalHome:			
Base program	--	\$40.0	--
Mobilehome ownership	--	10.0	--
Homebuyer's Downpayment Assistance	--	50.0	--
Farmworker Housing:			
Base program	\$3.5	35.5	\$18.5
Manufactured housing	--	3.0	--
Unhealthy and unsafe units	--	3.0	--
Health services demonstration	--	5.0	--
Self-help housing	2.0	2.1	2.1
<b>Multifamily Housing</b>			
Base program	\$11.0	\$188.0	\$31.0
Downtown Rebound:			

Project loans	--	22.6	3.0
Local government planning grants	--	2.4	1.4
<b>Homeless</b>			
Emergency Housing Assistance Program:			
Operating grants	\$2.8	\$14.0	\$14.0
Capital grants	--	25.0	--
<b>Other Programs</b>			
Code enforcement incentives	--	\$5.0	--
Interregional Partnership Pilot	--	5.0	--
Child Care Facilities	--	16.0	--
Central Valley Infrastructure Grants	--	--	\$20.2
Predevelopment loans	\$1.5	1.5	4.0
<b>Totals</b>	<b>\$20.8</b>	<b>\$538.1</b>	<b>\$294.2</b>
<sup>a</sup> This column shows the appropriations for these programs. The expenditures of these funds will occur over 2000-01 and 2001-02.			

### Local Government Incentives

Chapter 80, Statutes of 2000 (AB 2864, Torlakson), created the Jobs-Housing Balance Improvement Program in an effort to increase local housing and economic development activity. The 2000-01 budget appropriated \$110 million for three components of the program.

***Incentive Grants.*** The 2000-01 budget provided \$100 million to make "incentive payments" to local governments intended to increase housing production. The program is scheduled to make payments based on the level and type of housing permits issued in a jurisdiction during calendar year 2001. As discussed in more detail below, the Governor has proposed augmenting the program by \$200 million and making payments based on housing production in both 2001 and 2002.

***Economic Development Grants.*** Another component of the Jobs-Housing Balance Program will make \$5 million available to local governments to develop or implement economic development strategic plans in order to attract businesses to their communities.

***Predevelopment Loans.*** The department will also make \$5 million in low-interest loans available to local governments and nonprofit organizations for the predevelopment costs associated with

developing housing near transit stations. After these funds are allocated, the Governor proposes to merge this program with the department's other predevelopment loan programs--making repaid loan funds available to urban, rural, and housing preservation projects as well.

### **Homeownership Programs**

***CalHome Program.*** Chapter 84, Statutes of 2000 (SB 1656, Alarcon), created the CalHome program as the department's primary funding mechanism for promoting homeownership among low- and very-low-income households. The intent of the program was to consolidate a number of existing department programs and provide the flexibility to offer funding through a single application process. The program allows the department to make both loans and grants to local governments and nonprofit organizations for a variety of purposes, including downpayment assistance, rehabilitation, self-help housing, predevelopment costs, and shared housing. Of the \$50 million appropriated to the program in 2000-01, \$10 million was set aside to fund local programs that allow homeowners to repair or replace manufactured housing.

***Downpayment Assistance Program.*** Chapter 81, Statutes of 2000 (AB 2865, Alquist), created the California Homebuyer's Downpayment Assistance Program. The *2000-01 Budget Act* appropriated \$50 million to the department to contract with the California Housing Finance Agency (CHFA) for the administration of the program. The program, which is targeted to moderate-income families, is discussed in more detail in the analysis of CHFA's budget (please see Item 2260).

***Farmworker Housing Grant Program.*** The farmworker housing grant program provides local governments and nonprofit organizations with grants for the construction and rehabilitation of housing for the families of agricultural workers. The 2000-01 budget provided \$35.5 million for the base grant program and the department has received about \$28 million in application requests thus far. An additional \$10 million was appropriated for three separate components:

- ***Manufactured Housing Component.*** The budget set aside \$3 million for sites using manufactured housing for 12 or fewer employees in a cooperative arrangement between the employer and a nonprofit organization.
- ***Health and Safety Component.*** The budget reserved an additional \$3 million for manufactured housing projects needing assistance due to health and safety problems.
- ***Health Services Demonstration.*** The budget allocated \$5 million for a demonstration project funding farmworker housing projects that include health services. The department expects to enter a contract for the full amount with the Rural Community Assistance Corporation to administer the grants.

Each of these separate components will be eligible for future funding under the base program.

### **Multifamily Housing Programs**

***Multifamily Housing Program.*** Previously, the department funded multifamily projects through a variety of special purpose programs, such as a welfare-to-work housing program and a rehabilitation program. Similar to the CalHome program, Chapter 637, Statutes of 1999 (SB 1121, Alarcon), consolidated a number of multifamily housing programs, allowing the

department to fund a variety of project types through a single application. The new program received a \$188 million appropriation in 2000-01, with a proposed ongoing appropriation of \$31 million. In its initial funding application process this year (which made \$50 million available), the department received requests totaling \$175 million.

***Downtown Rebound.*** The Downtown Rebound program which was created by Chapter 83, Statutes of 2000 (AB 2870, Cedillo), and appropriated \$25 million in the 2000-01 budget for three components, intended to promote the revitalization of urban areas:

- ***Adaptive Reuse Loans.*** Most of the funds, \$19 million, are available for projects to reuse commercial or industrial buildings for residential units.
- ***Additional Housing Projects.*** Another \$3.6 million in loans is available for a variety of multifamily housing purposes, including adaptive reuse, in-fill of vacant sites, and housing near transit centers. The Governor proposes \$3 million in ongoing funds for the Downtown Rebound program to be eligible for these purposes.
- ***Local Government Planning Grants.*** The remaining \$2.4 million is available to local governments for planning grants for site inventories and feasibility studies, updates of general plans and zoning ordinances, and related purposes. The Governor proposes \$1.4 million in ongoing funds for planning grants.

## **Homeless Programs**

The state's primary program for the funding of homeless shelter services is the department's Emergency Housing and Assistance Program (EHAP). The 2000-01 budget contained \$39 million for two components of EHAP:

- ***Operating Grants.*** \$14 million of the funds are available to fund the ongoing services of homeless shelters. This level of funding is again proposed for 2001-02.
- ***Capital Loans.*** Forgivable loans totaling \$25 million are available for the construction, rehabilitation, or acquisition of shelter facilities.

## **Other Programs**

***Code Enforcement Incentives.*** Two new programs--designed to improve local enforcement of building codes--were created by Chapter 664, Statutes of 2000 (AB 1382, Lowenthal), and appropriated \$5 million in one-time funds. The department has received about \$30 million in applications for the two programs.

- ***Code Enforcement Incentive Program.*** This program (\$2.75 million) provides three-year grants to local jurisdictions to increase staffing for local code enforcement activities. The maximum grant amount is \$1 million, and local matching funds must increase over the life of the grant.
- ***Community Code Enforcement Pilot Program.*** This program (\$2.25 million), with a maximum grant amount of \$450,000, emphasizes improving cooperation between code enforcement officials and prosecution agencies, health departments, housing agencies,

and schools.

***Interregional Partnership Pilot Program.*** This program, funded at \$5 million, will provide grants to assist local governments undertaking interregional planning for housing and employment issues, with a particular emphasis on improving geographic mapping.

***Child Care Facilities.*** The budget appropriated \$16 million for the Child Care Facilities Financing Program. The funds can be used for either direct loans or loan guarantees for child care facility purchases, expansions, or renovations. In the *2000-01 Analysis*, we reported that the program was having administrative difficulties in distributing \$7 million in funds appropriated in the 1997-98 budget. In the past year, the department has made only \$485,000 in new direct loans and another \$614,000 in loan guarantees. As a result, \$3.7 million of the original 1997 appropriation is still available for loans and guarantees, and the department has yet to use any of the current-year's appropriation. The 2000-01 budget requires that the department report on the program by March 15, 2001, including a discussion of any impediments to increased participation.

## **New Housing Proposals**

### **Payments to Local Governments Unlikely to Change Behavior**

***We recommend redirecting the proposed \$200 million augmentation for incentive payments to local governments to a more effective approach to addressing the state's lack of housing development. As a one-time program, the payments will fail to change the underlying disincentives for local governments to build housing. In the program's place, we suggest more targeted options for either one-time or ongoing appropriations. (Delete Item 2240-114-0001 and Item 2240-114-3006.)***

***Background.*** The current system of local government finance generally does not encourage local governments to approve housing projects, particularly multifamily and affordable housing developments. The jurisdiction which approves the housing receives a relatively small share of the property taxes generated from the new development. These revenues, in many cases, are not enough to pay for the costs of providing services to the new housing.

The state's major oversight of local housing policy is the housing element process. As part of their general plan, cities and counties must develop a housing element which adequately plans for future needs in housing, particularly a "fair share" of the region's expected affordable housing needs. In order to be in compliance with state law, HCD must approve a community's housing element. Less than 70 percent of communities are currently in compliance with the housing element law.

***Program Created in 2000-01.*** The Jobs-Housing Balance Improvement Program was created last year and appropriated \$100 million to make incentive payments to local governments with the intention that the payments would encourage greater housing production. Early in 2001, the department will issue its guidelines to local governments on what basis these funds will be distributed. While the department is still finalizing its guidelines, it has outlined the following framework for the payments:

- Payments will be made in January 2002, based on the level of housing permits issued in calendar year 2001.
- Jurisdictions will be eligible for payments only if they (1) have their housing element in compliance with state law by the end of 2001 and (2) issue housing permits in 2001 that exceed their average permit issuance from the prior three years by a yet-to-be-determined percentage (in the range of 10 percent to 25 percent).
- If jurisdictions meet these two criteria, then payments would be made on a per-unit basis to each jurisdiction for the following: (1) all permits issued above the three-year average percentage threshold; and (2) additional amounts for priority units: multifamily, "in-fill", those with affordability restrictions, and those sold within county affordability limits. Units which met more than one of these criteria would be eligible for multiple incentive payments.

In its guidelines, the department will outline a range for the per-unit payments, but the department plans to finalize the amounts of the payments and their criteria only once the total number of units built is known at the end of 2001. Current law restricts the use of the payments by local governments for capital outlay projects.

***Governor Proposes Expanding the Program.*** The Governor proposes augmenting the program by \$200 million in this year's budget. Under the proposal, \$50 million would be added to the current-year's payments so that \$150 million would be paid to local governments in both 2001 and 2002. In addition, the Governor proposes allowing local governments to spend the payments for any purpose.

The department correctly assesses that housing production will not dramatically change without significant market-based incentives. Unfortunately, the program that they have developed suffers from fundamental shortcomings that will prevent it from providing significant enough incentives to change most local governments' behavior.

***One-Time Program Will Fail to Influence Long-Term Decisions.*** Local government decisions about whether to authorize housing construction are made with a view to their long-term impact—for instance, service costs for the coming decades, the impact on the community's long-term character, and other potential land uses for the area. In most cases, a *one-time* receipt of funds is unlikely to outweigh a community's long-term considerations.

***Benefits Unknown at the Time of Housing Approval.*** Increasing the amount of revenues generated by the approval of a housing project (through incentive payments) would reduce the gap between the revenues generated and the costs of providing services to that project. This could, in turn, encourage local governments to approve more housing projects. The method in which the program is proposed to be implemented, however, would limit the change in incentive structure. Since the program's incentive payments would be made (1) after the end of the year and (2) based on the *total* amount of housing approved, a local government will be unable to depend on any increased revenues when approving an individual project. For example, if a city council is considering the approval of a housing project in June, it has little way of knowing if it will approve enough housing during the following six months to meet the various thresholds necessary to receive incentive payments. Thus, the city council can not count on the incentive payments in its calculations of the costs and revenues associated with the particular housing project.

Moreover, the department is reserving the right to adjust the payment amounts and criteria after the end of the year. This will further prevent a local government from knowing exactly how much to expect in increased revenues at the time of housing approvals.

***Fails to Improve Current System of State Oversight.*** In order to be eligible for the incentive payments, some additional communities will likely comply with state housing law. The current system of state oversight, however, makes limited efforts to ensure that any community stays in compliance between periodic updates. Furthermore, the system makes no effort to determine if a community actually builds enough housing to accommodate the growing demand. Thus, the current system fails to provide significant rewards to local governments which comply with state housing law, and appropriate consequences to those governments which do not. By maintaining the existing housing law system separate from the incentive payments, the administration misses a significant opportunity to make state housing oversight a more meaningful, long-term process.

***Without Changing Behavior, Windfall Payments Only.*** Most communities are likely to produce a similar amount of housing in 2001 as they have in the past three years. Whether they produce enough housing to meet the department's thresholds will depend on a variety of factors, such as general economic conditions, amount of available land, developer interest, and community support for more housing. As outlined above, we do not find reason to believe that many communities will dramatically alter their approach to housing as a result of this program proposal. Consequently, the vast majority of the program funds will make payments to local governments for actions that they would have taken regardless of the program's existence. For these governments, the payments will serve as a "windfall." While windfall payments may *reward* communities for supporting housing, the program would fail in its aim to *alter* the behavior of local governments.

***Search for Better Solution.*** Given our analysis that the program will fail to change local government behavior, we recommend redirecting the proposed \$200 million augmentation. (The same analysis applies to the current-year appropriation of \$100 million, but we recognize that the Legislature already made this commitment of funds to local governments.) We propose two alternatives based on the level of funding that the Legislature is willing to commit to this purpose.

- ***Fund More Multifamily Housing.*** If the Legislature wishes to maintain the funding on a one-time basis, we would instead recommend appropriating funds to the department's multifamily housing program. The program funding would ensure that a sizable amount of affordable multifamily units is produced (the least likely units to be developed under the current incentive system).
- ***Develop More Focused Ongoing Program.*** We believe that with ongoing funding an incentive program could be developed that would be better able to alter local government behavior. In developing such a program, we would emphasize that: (1) governments know the specific benefits of the program *at the time* of issuing housing permits, (2) the program integrates with the state's oversight system, and (3) the amount of windfall payments are limited to the extent possible. Specifically, we would recommend more explicitly integrating the program with the housing element process--rewarding those local governments that implement, rather than just get approval for, their housing elements. Such a system could award dollars to local governments for each unit of

housing provided to meet its share of the region's affordable housing demand. The \$200 million could be sufficient to fund a number of years of such a program, if the payments were more targeted to the most difficult to develop affordable units (rather than all housing units).

### **Infrastructure Program Not Targeted to Problem**

***We recommend deleting the proposed \$20.2 million in funding for a new Central Valley Infrastructure Grant Program. The program would not address the underlying problem, other infrastructure programs already exist, and the funding would not make a significant impact. Improving locally controlled infrastructure financing tools or better targeting the existing state programs would be more effective approaches to financing local infrastructure projects. (Reduce Item 2240-001-0001 by \$200,000 and Item 2240-101-0001 by \$20 million.)***

The Governor proposes a one-time appropriation of \$20.2 million for a new Central Valley Infrastructure Grant Program. The program would provide grants of up to \$1 million to local governments in the Central Valley for selected infrastructure projects related to water and wastewater systems, utilities, streets, or communications. Grants would only be given to projects determined to promote economic development, and the department expects to fund no more than 25 projects with the funds. We have a number of concerns with this proposal, which we outline below.

***Does Nothing to Address Underlying Problem.*** Infrastructure funding for local governments is generally a local responsibility in California. The administration has proposed this program presumably with the belief that Central Valley local governments are unable to fulfill this responsibility on their own. However, the program would do nothing to change the underlying problem facing these local governments--the difficulties communities face in financing their own infrastructure needs. Moreover, it is unclear why other rural governments outside of the Central Valley, or local governments more generally, do not face the same problems. Yet, the program would provide no funds to these other communities.

***Other State Programs Already Exist.*** Two state programs already exist with very similar purposes to the proposed program.

- ***The CDBG Program.*** Most large cities and counties receive CDBG funds directly from the federal government and can use the funds at their discretion for a variety of housing and economic development projects. The CDBG program administered by HCD provides federal funds to small jurisdictions (cities with populations less than 50,000 and counties less than 200,000) through a competitive application process. The HCD component of CDBG will distribute an estimated \$47 million to local governments in the budget year. While the federal government sets basic guidelines for the distribution of these funds, the state--through statute and program regulations--has broad authority to set funding priorities. Infrastructure projects are currently an eligible use for nearly all of the HCD funds. The department reports that in recent years, however, the majority of projects funded have been housing rehabilitation projects.
- ***Infrastructure Bank.*** The state infrastructure bank, administered by the Technology, Trade, and Commerce Agency, was created in 1994 and provided a total of \$475 million

through the 1998-99 and 1999-00 budgets. The bank provides low-interest loans for local government infrastructure projects similar in nature to those proposed to be funded by the Central Valley Infrastructure Program.

Given the existing programs that can fund local infrastructure projects, it is unclear why the state needs another, more specialized infrastructure financing program.

***Amount of Funding Will Not Make Significant Impact.*** The Governor's proposed program would not significantly change the status of infrastructure in California, due primarily to (1) the limited number of projects funded and (2) the high cost of infrastructure projects. Compared to the hundreds of millions of dollars of funding for infrastructure from local sources, the CDBG program, and the infrastructure bank, the impact of the Governor's proposal would be marginal.

***Better Options to Address Problem.*** Given these concerns with the program, we recommend deleting the proposed \$20.2 million in funding. If the Legislature decides that Central Valley infrastructure, and rural infrastructure more generally, is a funding priority for the state, there are a number of options that would more effectively address the lack of infrastructure financing options for local governments.

- ***Improve Infrastructure Tools Available to Local Governments.*** The *long-term* solution to a local government infrastructure financing problem would be to improve the existing local government finance system to allow communities to better meet their own needs. Locally controlled financing tools would allow communities to determine which projects are the highest priority locally.
- ***Better Target Existing Infrastructure Programs.*** A more immediate approach to addressing local infrastructure needs would be to adjust the state's existing infrastructure programs to better match the Legislature's funding priorities. If the state CDBG program and the infrastructure bank are not meeting the Legislature's objectives, then the funding criteria for these programs should be revised to reflect current priorities.

### **Employee Housing Costs Should Not Be Paid Twice**

***We recommend deleting a \$50,000 request for performing employee housing plan checks, as the department should collect the necessary funding from the local governments which already received the payment of permit fees for the work. (Amend the Employee Housing Act and reduce Item 2240-001-0001 by \$50,000.)***

The Employee Housing Act (EHA) gives the department responsibility for developing and enforcing standards for "employee housing"--generally defined as housing for five or more employees (1) provided in conjunction with employment or (2) provided for agricultural workers in rural areas. The majority of employee housing involves housing for farmworkers. Local jurisdictions may elect to implement the EHA on their own; otherwise, the department is responsible for enforcement.

***Concern Over Timeliness of Housing Approvals.*** When seeking to construct, rehabilitate, or repair employee housing, the housing owner must apply for a construction permit from the local building or health department and pay the corresponding fee for the permit. There has been some concern that the development of housing could be delayed through the permit process by local

communities resistant to employee housing. Specifically, an entity could prevent the housing by simply not acting on the permit application in a timely manner and by not performing the necessary check of the submitted plans for consistency with the appropriate building and health codes.

***Department Given New Responsibility in 2000.*** In response to this concern, Chapter 702, Statutes of 2000 (SB 1545, Costa), provides an alternative approval procedure for any employee housing application for agricultural workers that has not been either approved or denied by the local department within 60 days. In those instances, Chapter 702 gives HCD the authority to check the permit plans and approve the application, if appropriate. The owner can then proceed with the project as if it had received local approval.

***Request for Funding.*** As a result of the new plan-checking responsibility, the budget proposes an ongoing General Fund augmentation of \$50,000. The department proposes to use these funds to contract with the Department of General Services for the engineering services necessary to perform the plan checks. Since this is a new responsibility that depends on the actions of local governments, the department is unsure how many plan checks it will be required to perform. The requested funds would allow about 350 plan checks to be performed annually.

***General Fund Commitment Creates Wrong Incentives.*** We agree with Chapter 702's intent to prevent the unnecessary delay in the approval of farmworker housing projects. By granting the department's funding request, however, the state would create a fiscal incentive for some communities not to act on permit applications. Under current law and with the approval of HCD's funding proposal, the local department would be able to keep the fees collected for plan checks (generally several hundred dollars) without performing the associated work--by simply deferring to HCD's evaluation after 60 days. Chapter 702 gives no authority for HCD to collect the fees paid by an applicant to the local building department for the plan check. The Governor's proposal, in essence then, requests that the plan check be paid for twice--once by the applicant and once by the state's General Fund.

***Recommend Allowing Department to Recover Costs From Local Governments.*** We recommend that the department, by amending the EHA, be given the authority to collect the already paid plan-check fees from local governments for any plan checks that HCD performs. This would both prevent local governments from keeping the fees for services that they did not provide and allow the requested \$50,000 to be deleted from the budget.