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An Evaluation of the School Facility Fee Affordable Housing Assistance Programs

EXECUTIVE SUMMARY

Background

In November 1998, California voters approved Proposition 1A, which authorized $9.2 billion in state general obligation bonds for the financing of school facilities. Proposition 1A's companion legislation, Chapter 407, Statutes of 1998 (SB 50, Greene), went into effect upon the measure's approval by the voters. Chapter 407 appropriated $160 million for the School Facility Fee Affordable Housing Assistance Programs—designed to increase the affordability of new housing. Three of the programs reimburse purchasers of new homes for some or all of the school facility fees paid on their homes, with a fourth program that reimburses multifamily housing projects for their fees paid.

LAO Findings

- In their two years of operations, the four programs have had limited success in funding applicants. Thus far, the programs have expended only $3 million of their $100 million in appropriations.

- Those funded applications have been concentrated in the Central Valley, one of the state's most affordable regions.

- The programs treat similar home buyers differently. Because developer fees are not the sole method of taxing home buyers for the cost of school facilities, providing assistance based on the amount of developer fees paid excludes home buyers taxed in the alternate ways.

Recommendation

Given the programs' sunset date at the end of calendar year 2002, the funds already appropriated should be sufficient to fund the programs through their conclusion. In addition, our analysis raises a number of concerns with the programs. Accordingly, we recommend that the Legislature eliminate the $60 million in scheduled appropriations for the programs in 2001-02 and 2002-03—making the one-time funds available for other, more-targeted housing programs or other legislative priorities.

Introduction

In November 1998, California voters approved Proposition 1A, which authorized $9.2 billion in state general obligation bonds for the financing of school facilities. Proposition 1A's companion legislation—Chapter 407, Statutes of 1998 (SB 50, Greene)—went into effect upon the measure's approval by the voters. Chapter 407 significantly altered the system of fees that can be placed on new development in order to pay for the construction of school facilities. In addition, Chapter 407 appropriated $160 million for the School Facility Fee Affordable Housing Assistance Programs—administered by the California Housing Finance Agency (CHFA) and designed to increase the affordability of new housing. The legislation directed the Legislative Analyst's Office to evaluate the effectiveness of these housing programs.

Background

Changes to School Facility Developer Fees

School districts have a variety of funding mechanisms available to them to pay for the financing of school construction, including local general obligation bonds, local Mello-Roos bonds, developer fees, and state funding. Developer fees are charged by school districts on new residential and commercial construction to help offset the costs of the new school construction that the development will require. Prior to the passage of Proposition 1A, school districts were limited in the amount of school facility developer fees they could charge. Also, as a result of a series of court decisions in the years preceding the passage of Proposition 1A—known as the *Mira, Hart, and Murietta* decisions—cities and counties were able to impose additional school facility fees on development as a condition of obtaining land use approval.

Proposition 1A and Chapter 407 created different levels of developer fees. The former cap on fees—now known as "level I" fees—remains the maximum amount that a school district can charge except under specified circumstances. These level I fees are adjusted for inflation biennially, and as of January 2000, were $2.05 per square foot for residential construction and $0.33 per square foot for commercial construction. For a school district to impose a fee in excess of the level I amount, it must meet two of the following four criteria:

- Placed a local school bond on the ballot within the last four years and achieved voter approval of more than 50 percent.

- Have a substantial student enrollment in year-round classes.

- Approved local bonds equal to 15 percent (prior to the passage of Proposition 1A) or 30 percent (after its passage) of the district's statutory bonding capacity.

- Have 20 percent of the district's classrooms using "relocatable" structures.

The amount of fees that can be charged over the level I amount is determined by the district's total facilities needs and the availability of state matching funds. If there is state facility funding available, districts are able to charge fees equal to 50 percent of their total facility costs, termed "level II" fees. If, however, there are no state funds available, "level III" fees may be imposed for the full cost of their facility needs (that is, twice the amount of the level II fees). Chapter 407 also prevents cities and counties from imposing their own school facility fees until 2006, thereby suspending the previous court decisions until that time.

Single-Family Housing Programs

In response to the concern that developer fees can reduce housing affordability, Chapter 407 created three separate programs that provide new home purchasers with state funding for a portion or all of school district facility fees paid on their homes. These housing assistance programs were then modified by Chapter 127, Statutes of 2000 (AB 2866, Migden), to expand program eligibility and extend their sunset an additional year, from January 1 to December 31, 2002. The differences among these programs are summarized in Figure 1 and described in detail below.

Figure 1

Comparison of Single-Family Housing Programs

	Program 1 Economically Distressed Areas	Program 2 Sales Price Limit	Program 3 Moderate-Income First-Time Home Buyers
Income Limits	None.	None.	Moderate-income household limits.
Eligible Locations	Limited to "economically distressed counties" (currently 12 counties).	Available statewide.	Available statewide.
Sales Price Limits	175 percent of county median five-year sales price.	$130,000.	None.
Limited to First-Time Home Buyers?	No.	No.	Yes.
Amount of Grant	School facility fees paid above level I amounts.	School facility fees paid above level I amounts.	Total amount of school facility fees paid.

Each program shares the following characteristics:

- The building permit on the new home must have been issued after January 1, 1999.

- Funds are available on a first-come, first-serve basis by application to CHFA.

- Funding may be combined with other government or private financing programs.

- State funds offsetting the cost of developer fees are deposited into the home buyer's escrow account prior to closing.

- If the home buyer does not occupy the home for five years, a pro-rated portion of the assistance must be repaid.

Program 1: Economically Distressed Areas. The first program is only available for home buyers in "economically distressed counties." These counties are defined in statute as those counties:

- Having unemployment rates exceeding 125 percent of the statewide average.

- Which had 500 or more residential structures constructed in the county during 1997.

Currently, 12 counties meet this definition (see Figure 2). While the program has no limits on a buyer's income, the home purchased cannot exceed 175 percent of the county's median five-year sales price. For the year 2000, these purchase price limits ranged from $186,000 in Merced County to $352,000 in San Benito County. The program reimburses a home buyer for the portion of their school facility fees paid that is above the level I fee amount.

Figure 2

Economically Distressed Counties

2000

Butte	Monterey
Fresno	San Benito
Kern	San Joaquin
Kings	Shasta
Madera	Stanislaus
Merced	Tulare

Program 2: Sales Price Limit. Any home buyer in the state—regardless of county or household income—is eligible for the second program if their new home is purchased for less than $130,000. Chapter 127 raised this sales price limit from $110,000, and the limit is now adjusted annually for changes in statewide median home sales prices. Like Program 1, this program reimburses buyers for the portion of their school facility fees paid that is above the level I fee amount.

Program 3: Moderate-Income First-Time Home Buyers. The third program is unique from the other two in a number of ways:

- ***Restricted by Home Buyer's Income.*** Originally, the program was restricted to low-income households (less than 80 percent of county median income, adjusted for family size). Chapter 127, however, raised that limit to moderate-income households (120 percent of median income) in order to expand eligibility.

- ***Full Reimbursement of Fees.*** This program is also the only one which reimburses home buyers for the full amount of school facility fees paid to a school district.

- ***First-Time Home Buyers.*** This program is restricted to first-time home buyers.

Multifamily Housing Program

In addition to the single-family programs discussed above, Chapter 407 also created a funding program for the reimbursement of school facility developer fees for the construction of new multifamily housing units. A development is eligible for the reimbursement of all fees paid to school districts in exchange for dedicating a portion of the project's units for very-low-income households (50 percent of county median income, adjusted for household size) for a period of 55 years. The number of units required to be dedicated must be in the same proportion to total units as the share of fees paid is to total construction costs. For example, if developer fees were 2 percent of total construction costs, a developer would have to dedicate four units of a 200-unit project to very-low-income households.

Program Funding

Chapter 407 appropriated $160 million over five fiscal years from the General Fund to the Department of General Services for the developer fee programs. The department contracts with CHFA for the administration of these programs. Figure 3 (see next page) shows the fiscal-year appropriations to the four programs. For the economically distressed areas and sales price limit programs, any funds not expended within 18 months of their appropriation may be transferred to the moderate-income first-time home buyers program. Any unspent funds at the time of the program's sunset—December 31, 2002—will revert to the General Fund.

Figure 3

Appropriations of Funding for the School Facility Fee Programs

(In Millions)

Program	1998-99	1999-00	2000-01	2001-02	2002-03	Total
Economically Distressed Areas	$3.5	$7.0	$7.0	$7.0	$3.5	$28.0
Sales Price Limit	3.5	7.0	7.0	7.0	3.5	28.0
Moderate-Income First-Time Home Buyers	6.5	13.0	13.0	13.0	6.5	52.0
Multifamily Housing	6.5	13.0	13.0	13.0	6.5	52.0
Totals	**$20.0**	**$40.0**	**$40.0**	**$40.0**	**$20.0**	**$160.0**

Experience to Date

Single-Family Programs. Although they have been functioning since the beginning of 1999, the single-family programs have expended few of their available funds (see Figure 4). Of the 748 applications that have been approved through the three programs, home buyers have received an average reimbursement of less than $2,500.

Figure 4

Single-Family Program Expenditures

Through August 31, 2000
(Dollars In Millions)

Program	Available Funds	Expenditures	Number of Approved Applications
Economically Distressed Areas	$17.5	$0.2	75
Sales Price Limit	17.5	0.0	1
Moderate-Income First-Time Home Buyers	32.5	1.6	672
Totals	**$67.5**	**$1.8**	**748**

After some experience with the programs, CHFA identified a number of problems and proposed a series of statutory changes to increase their use. These changes were incorporated into Chapter 127, effective beginning July 1, 2000. For the sales price limit program, very few homes in California were being constructed for less than the original purchase price limit of $110,000. Therefore, the limit was raised to $130,000 and is now adjusted annually for changes in statewide home sales prices. The first-time home buyer program was originally limited to households of low-income. Few households of this income level, however, are in the position of purchasing homes. Thus, this program was expanded to include moderate-income households.

As of September 2000, home buyers in 22 counties had received funding from the state. Four counties—Fresno, Kern, Riverside, and Tulare—represent more than 60 percent of the single-family programs' expenditures. The concentration of applicants in the Central Valley should not be particularly surprising, given that this area is one of California's fastest growing housing markets and often relies on the use of developer fees to finance new school construction.

Multifamily Program. Likewise, the multifamily housing program has had limited success in funding applicants. From its allocation of $32.5 million so far, seven projects have been funded for a total of $1.1 million, and another 34 projects have been approved with expected expenditures of $3.7 million. Due to the complexities of multifamily affordable housing financing and construction, the program takes a particularly long time to move from initial application to finished construction—typically a minimum of one year.

Concerns About the Programs

Our review of these housing assistance programs indicates a number of concerns with their operation, which we discuss below.

Lack of Applications Threatens Viability of Programs

Without a dramatic expansion in home buyer and multifamily developer interest in the programs, the programs will continue to be an ineffective effort to increase housing affordability. So far, CHFA has limited its marketing efforts primarily to the real estate industry, such as lenders, brokers, and real estate agents. The department is now in the process of developing a marketing strategy aimed at the general public. The CHFA hopes that a greater awareness by the public of the programs will expand applications.

While increased public awareness and the changes to the single-family programs implemented by Chapter 127 will increase their use somewhat in the future, the programs will be unlikely to expend their total funding allocations by the programs' sunset date of December 31, 2002. In order to expend all of the program funds by the sunset, applications would need to grow by more than 30 times over their current levels in the next two years.

Similar Home Buyers Treated Differently

Home buyers will typically pay for the local cost of their school facilities through a combination of developer fees, Mello-Roos bonds, and property tax overrides for general obligation bonds. Each of these financing mechanisms adds to the cost of housing, while providing revenues for local school facilities. The CHFA developer fee programs, however, only provide assistance for one type of these financing mechanisms. As a result, a home buyer who elects to buy a home in a school district using developer fees would be eligible for state assistance. Another similar home buyer opting to purchase a home in a district using Mello-Roos bonds would not be eligible for any assistance. Similarly, purchasers of resale homes, including first-time home buyers, are not eligible for any assistance—even though they will likely bear the cost of school facility repair or reconstruction costs through some other financing means.

Because developer fees are not the sole method of taxing home buyers for the cost of school facilities, providing assistance based on the amount of developer fees paid excludes home buyers taxed in the alternate ways. We find little policy rationale for assisting home buyers in districts financing school facilities with developer fees but providing no assistance to others in districts which opt for other financing alternatives.

Programs Not Targeted to Highest Need

The developer fee reimbursement programs do not appear to be targeted to the Californians most in need of housing assistance. Given the limited level of housing assistance available to Californians, these programs fail to strategically target assistance for the "highest and best use" of state General Fund housing dollars.

Funds Spent in Most Affordable Areas. The Central Valley—where the majority of program funds have been allocated—is one of the state's most affordable markets for home buyers. For instance, measured in terms of the percentage of households that can afford a median-priced home in a region, the Bay Area, Central Coast, and most of Southern California are less affordable than the Central Valley. Consequently, the program is not providing significant amounts of assistance in the regions of the state where housing affordability problems are most severe. While developer fees may increase the cost of housing in the Central Valley, other regions suffer from more severe housing affordability problems due to a variety of other factors, such as high land costs, other types of development fees, and regulatory barriers.

Recipients May Not Have the Highest Need. Both the economically distressed areas and the sales price limit programs are available to existing home owners, regardless of income, who are moving to a newly constructed home. Existing home owners have already overcome the major barriers to first-time home ownership. While the developer fee reimbursement may provide them the flexibility to purchase a slightly more expensive home, the programs will not represent the difference between renting and home ownership.

RECOMMENDATION

The four developer fee programs have spent less than $3 million of the $100 million that has already been appropriated to them. The effect of Chapter 127's modifications, combined with CHFA's intensified marketing efforts, should increase the use of the programs somewhat. Yet, with the programs' sunset date at the end of calendar year 2002, the funds already appropriated should be sufficient to fund the programs through their conclusion. Given that, along with the above concerns raised about the programs, we recommend that the Legislature amend state law to eliminate the additional appropriations scheduled for the programs in 2001-02 and 2002-03. This action would make an additional $60 million in one-time funds available for other, more-targeted housing programs or other legislative priorities.

Acknowledgments

This report was prepared by Michael Cohen with the assistance of Sona Nagar, under the supervision of Mac Taylor. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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