The ABCs of JPAs

California’s new tool for creating middle-income housing
Acknowledgments

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This brief reflects the views of SPUR and the Terner Center for Housing Innovation and not necessarily the views or perspectives of the individuals listed below or their organizations. Any errors are the authors' alone.

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A New Model for Middle-Income Housing

One of the biggest challenges to expanding the supply of affordable housing is a shortage of public subsidies that can help to close the gap between development costs and affordable rents. A new model has enabled developers to acquire and preserve units affordable to middle-income households — those who earn between 80% and 120% of the area median income (AMI). In exchange, the housing project receives tax benefits, eliminating the need for direct public funding.

The new model is a joint powers authority or JPA — a structure in which public entities join together to address a common problem. The first JPA in California to acquire housing and make it affordable to middle-income households was formed in Santa Rosa in 2019. Since then, over 40 JPA acquisition deals totaling at least 13,800 units have been approved in California. As one example, in May of 2021, the City of Pasadena approved the acquisition of two apartment complexes, totaling over 500 units, which were subsequently restricted for middle-income housing. Pasadena city staff praised the JPA model, saying that it “addresses the root cause of the affordable housing crisis: that housing costs have been increasing at a much faster rate than people’s incomes.” To date this model has only been used to acquire existing buildings, but some developers are currently planning to use it to build new middle-income units.

Despite its rapid expansion, some cities and stakeholders have raised concerns about the JPA model. In San José, for example, city staff recommended that the city council not move forward with JPA-sponsored acquisitions, citing concerns about whether the affordability levels would be commensurate with the forgone property tax revenue, among other things.

Balancing the benefits of the JPA model with the downside risks is important to ensuring that its expansion contributes to alleviating the state’s affordable housing shortage. This brief explains how the JPA model works and how it is being used to produce affordable units as part of market-rate property acquisition and development. The analysis draws on conversations from a working group put together by SPUR and the Terner Center for Housing Innovation, interviews with stakeholders and a national literature review. The brief concludes with principles for how to structure JPAs in California to ensure that projects deliver meaningful public benefits.

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2 Ryan Carter, “Pasadena’s ‘missing middle’ is getting a rent break at these 2 projects,” June 16, 2021, https://www.pasadenastarnews.com/2021/06/16/pasadenas-missing-middle-is-getting-a-rent-break-at-these-2-projects/
Property tax incentive programs for affordable housing are not new. Programs in Washington and New York states have been successful in using property tax exemptions to entice private developers to voluntarily produce thousands of deed-restricted housing units, which are price restricted and rented only to those with lower income levels over a set period of time. By offering property tax exemptions of varying degrees, these programs eliminate the need for scarce traditional affordable housing funding sources, such as Low-Income Housing Tax Credits or direct state subsidies. A similar model exists in Texas, where the Public Facilities Corporations exemption (Section 303.042(f)) allows developers to partner with local government entities to receive property tax exemptions, as well as sales tax exemptions on construction materials, in exchange for providing affordable housing.

Figure 1 presents the high-level details of how these programs are structured. In each case, the state specifies the share of units that need to be deed-restricted as affordable housing, as well as the affordability level for the unit and how long the deed restriction will apply. Establishing these guidelines is important but challenging: Applying expansive affordability requirements (e.g., requiring a greater share of affordable units or deeper levels of affordability) can disincentivize developers from pursuing the tax exemption altogether, meaning no new affordable units get built. Weaker affordability requirements could result in valuable tax dollars being spent on projects that aren’t providing enough public benefit.

4 https://ternercenter.berkeley.edu/research-and-policy/finding-common-ground-rent-control/
Before the emergence of this new JPA model, property tax exemptions in California were more limited\(^5\) and could not be used to incentivize inclusionary affordable homes in market-rate development or to serve moderate-income households. In addition, due to the state’s tax policy reform rules, the formal creation of a property tax exemption program similar to New York or Washington’s would require a two-thirds majority vote in the California State Legislature and a statewide ballot initiative. Bills proposing property tax exemptions along these lines have been introduced in the California legislature in recent years but have not passed out of initial committees. However, the emergent California JPA model offers an alternative path for using property tax exemptions by taking advantage of existing statutory authorities that have not historically been used for housing.

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\(^5\) Developers of 100% affordable housing projects, such as under LIHTC, do benefit from property tax exemptions through the Welfare Property Tax Exemption.
How Does the Model Work?

This new tool relies on a joint powers authority — an institutional arrangement in which public entities create another legal entity or establish a joint approach to work on a common problem, fund a project or act as a representative body for a specific activity.6 In the case of housing, a JPA allows municipalities to act jointly to issue bonds and hold property.7 In California, three JPAs are currently engaged in creating or acquiring housing and making it affordable to middle-income households: the California Community Housing Agency (CalCHA), the California Municipal Finance Agency (CMFA) Special Finance Agency, and the California Statewide Communities Development Authority (CSCDA) Community Improvement Authority. In addition, other regional governmental agencies are currently exploring this model. For the purposes of this paper, we refer to this model as JPA-owned middle-income housing.

The benefits of the JPA model are two-fold. First, the JPA is eligible for tax exemptions on the property it holds. This can lead to substantial financial benefits to the owner of the property, which can be passed on to the renter in the form of lower rents. Just as government-owned properties like city halls, roads and parks are not taxed, JPA-owned middle-income housing is not taxed. This is a different property tax exemption from the one used by most affordable housing developments in California. The latter is a welfare property tax exemption that can be accessed by nonprofits for projects that are affordable to households earning 80% of AMI and that use some amount of direct public subsidy.

Second, JPA-owned middle-income housing can use tax-exempt bond financing. Governmental entities have broad authority to issue tax-exempt bonds to finance facilities that provide a public benefit, including government buildings such as new community centers, schools or other types of public facilities. This provides the project with comparatively cheaper debt capital that can be used for purchasing existing multifamily housing and doing any needed renovations and upgrades. These tax-exempt bonds are not subject to the same federal volume caps as those for Low-Income Housing Tax Credit projects and therefore these projects do not compete with traditional affordable housing developments for subsidies.

To use this model, a private real estate developer working on behalf of a JPA, referred to in these deals as the “project administrator,” typically identifies an apartment building for purchase and then approaches the city where the building is located to see if the city is interested in pursuing the acquisition as JPA-financed housing.8 If the city is interested and hasn’t previously worked with that JPA, the city council must vote to join the JPA and approve a public benefit agreement detailing the programmatic authority. The project administrator then facilitates the acquisition of the property, assembles the financing and the development plan, and oversees the long-term asset and property management. The JPA issues the bond debt, purchases the property

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6 https://sgf.senate.ca.gov/sites/sgf.senate.ca.gov/files/gwtfinalversion2.pdf
7 The Joint Exercise of Powers Act, as codified in California Government Code section 6500, governs JPAs. Under the Act, JPAs are restricted to public agencies, which can include, but is not limited to, the federal government, the state or state departments, mutual water companies, public districts and recognized Indian tribes.
8 This model can also be used by counties for their unincorporated lands.
and places regulatory restrictions on the resulting units to make them affordable over an extended period of time.

No earlier than 15 years after acquisition, or under a later date as specified in the city’s public benefit agreement, the city can choose to pay off outstanding debt and take ownership of the property. At that point, the city can restructure the property, assign the property to a third party to maintain long-term affordability or sell the property on the real estate market (typically the regulatory agreement limiting rents remains in place for the term of the bonds). The city is the beneficiary of any appreciation and equity developed during the period that the JPA owned the property. The project administrator can continue to be involved in the project in an asset and property management oversight role.

For the city, there are significant benefits to expanding affordable housing supply through this model: The jurisdiction is not obligated to contribute any subsidy, nor is it exposed to any direct financial or legal liability. The only direct impact is a reduction in general property tax revenue as acquired real estate moves off the tax rolls. The city’s tax loss can also be recuperated upon the sale or a refinance of the property.

FIGURE 2
How JPA-Owned Middle-Income Projects Work
In order to create middle-income housing, cities must first agree to join a JPA. The JPA then issues tax-exempt bonds and uses its property tax exemption to purchase a property or finance the creation of a new project. After a set period of time, the city can exercise its option to purchase the property from the JPA, after which the city can determine what to do with the project.

Source: SPUR and Terner Center analysis
Affordability Benefits

The tax savings from JPA-owned middle-income housing — from both property taxes and income exemptions on the bond debt — enable JPAs to make highly competitive bids for existing properties and support lowered rents with long-term affordability restrictions.

To date, JPA-owned middle-income housing typically restricts one-third of units affordable to households who make no more than 80% of AMI, one-third of units affordable to households at no more than 100% of AMI and one-third of units affordable to households at no more than 120% of AMI or below. However, some acquisitions, such as 777 Place in Pomona, have gone as deep as one-third of units affordable to households at 50% of AMI. In the case of acquisition and rehabilitation of existing housing, residents who income qualify for units may enjoy rent reductions when their lease is renewed, if the affordable rents are below what they are currently paying. Households with incomes over the limit continue to pay market rents until they move out, at which time the rents for those units revert to the income-restricted levels. Rent increases for both the affordable and market-rate units in the property are typically limited to the lesser of AMI growth or 4% per year. This is particularly valuable in the context of properties built within the past 15 years, which otherwise would be exempt from local or state rent caps. The terms of the deed restriction and the bond financing are typically 30 to 40 years.9

Unlike traditional affordable housing projects that leave long-term ownership with private or nonprofit developers, the JPA model allows cities to directly retain long-term control of the real estate asset and potentially access associated equity benefits.

So far, JPA financing has only been used in California to acquire existing properties. However, this model can also support the construction of new deed-restricted rental units that don’t compete with existing local or state subsidy sources. California-based developers are currently in the planning stage for several new construction projects, including at least one that is expected to break ground in 2023.

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9 Existing deals have generally allowed cities to pay off outstanding debt after 15 years to take title to the property from the JPA. It is typically a requirement of the public benefits agreement that cities have a purchase option or can force a sale of the property starting in year 15.
Two Case Studies: Acquisition and New Construction

Creekwood Apartments (a completed acquisition) and Clover Apartments (a proposed new construction project) offer examples of how JPA-owned middle-income housing works in practice, though each deal structure has unique features reflecting what was negotiated between the project sponsor and the local jurisdiction.

Creekwood Apartments

HAYWARD

In 2021, Catalyst Housing Group and the CalCHA JPA participated in the acquisition and conversion of Creekwood Apartments, an existing 309-unit multifamily property in Hayward. As part of the acquisition, the project administrator and JPA agreed to restrict the units one-third each at 80%, 100% and 120% of AMI. The transaction resulted in a discount in rents to the residents at the 80% and 100% AMI income levels, while the 120% AMI rents remained at market rate. Moving forward, rent growth will be restricted for all units to the lesser of AMI growth or 4%. (The year over year annual rent growth in Hayward between May 2021 and May 2022 was 6.37%.)

10 Calculated using Apartment List rent data for May 2021 and May 2022.
PROJECT DETAILS

UNITs:
309 total:
24 studios, 154 1-bedrooms, 131 2-bedrooms

INCOME MIX:
33% at 80% of AMI
33% at 100% of AMI
33% at 120% of AMI

YEAR BUILT:
1978

AT ACQUISITION:
90% occupied

JPA:
CalCHA

PROJECT ADMINISTRATOR:
Catalyst Housing Group

PROPERTY MANAGEMENT:
Greystar Real Estate Partners

Aggregate rent reduction
→ Gross potential rents 2020: $8.7 million (actual)
→ Gross potential rents 2022: $7.3 million (projected)

<table>
<thead>
<tr>
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<th>80% RENTS POST-CONVERSION</th>
<th>100% RENTS POST-CONVERSION</th>
<th>120% RENTS POST-CONVERSION</th>
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<tr>
<td>Studios</td>
<td>$1,700</td>
<td>$1,850</td>
<td>$2,000</td>
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<td>1 bedrooms</td>
<td>$1,942</td>
<td>$2,092</td>
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<tr>
<td>2 bedrooms</td>
<td>$2,344</td>
<td>$2,529</td>
<td>$2,600</td>
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<td>Average</td>
<td>$2,094</td>
<td>$2,259</td>
<td>$2,409</td>
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<td>Discount to Market Rents</td>
<td>13.1%</td>
<td>6.2%</td>
<td>0%</td>
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Note: Cap on annual rent increases is lesser of AMI growth or 4%.

Funding Sources
$174 million tax-exempt debt
→ $169 million Series A bonds at 4% rate with 33-year term
→ $5 million subordinate Series B bonds at 10% rate with 33-year term

Funding Uses
$174 million total
→ $129 million acquisition
→ $20 million capital reserves
→ $13 million financial reserves

11 Source: https://emma.msrb.org/P21446890-P2123128-P21534824.pdf
12 The rates noted are the rates at which the bonds were listed (the “coupon”); the actual pricing for the bonds was a function of what market pricing landed at. In this case, the effective blended cost of financing was 3.375%.
→ $5 million subordinate B bonds
→ $3 million cost of issuance
→ $2 million acquisition fee
→ $1 million issuance fees

**Total annual foregone property taxes:**
$1.06 million (2020 assessment)

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**Clover Apartments**

**SACRAMENTO**

Clover Apartments, a new construction project being built by AMCAL along with the CMFA JPA, is an example of how the JPA model can be used to build new housing affordable to middle-income earners. Upon completion, the project will restrict units between 80% and 120% AMI via a 55-year regulatory agreement. The project differs from conventional market-built housing in two ways: It will be entirely financed by city-authorized tax-exempt bonds and it will leverage the property tax exemption. Notably, all construction workers must be paid prevailing wages.
According to an analysis completed by the project administrator, the cumulative rent discount to market is greater than the foregone property tax revenue.

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<th>CONCORD GROUP MARKET STUDY RENTS</th>
<th>80% RENTS</th>
<th>100% RENTS</th>
<th>120% RENTS</th>
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<tr>
<td>1 bedrooms</td>
<td>$1,950</td>
<td>$1,692</td>
<td>$1,794</td>
<td>$1,950</td>
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<tr>
<td>2 bedrooms</td>
<td>$2,285</td>
<td>$1,904</td>
<td>$2,100</td>
<td>$2,285</td>
</tr>
<tr>
<td>3 bedrooms</td>
<td>$2,756</td>
<td>$2,114</td>
<td>$2,535</td>
<td>$2,756</td>
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<tr>
<td>Average</td>
<td>$1,892</td>
<td>$2,117</td>
<td>$2,307</td>
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<tr>
<td>Discount to Market Rents</td>
<td>17%</td>
<td>8%</td>
<td>0%</td>
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Note: Cap on annual rent increases is the lesser of AMI growth or 4%.

Funding Sources
$174 million tax exempt bonds
→ $125 million Series A tax-exempt bonds
→ $49 million Series B tax-exempt bonds

Funding Uses
$174 million total
→ $130 million development costs, including a 5% developer fee
→ $24 million capitalized interest (24 month of Series A bond interest, 50 months of Series B interest)
→ $1 million capital expense fund (12 years at $300 per unit per annum)
→ $10.5 million debt service/coverage fund (including 25% debt service coverage)
→ $1.5 million operating account (3 months) and extraordinary expense
→ $2 million joint powers authority and admin reserve fund (10 years authority and admin fees)
→ $5 million cost of issuance/underwriting fees

From AMCAL pro forma information, March 1, 2022
Concerns About the JPA Model

While there are benefits to the JPA model, there are also causes for concern:

1. **The level of affordability may not be deep enough.**
   Critics assert that moderate-income rents may be at or close to market rents in many communities and/or that units set aside for low-income households should have rents that are reduced even further. The lack of a clear benchmark for a minimal level of affordability has left JPAs and industry participants with the task of collectively setting the standard. Furthermore, for most of the initial project acquisitions, residents were assumed to be able to pay 35% of their income toward rent as opposed to the 30% that is standard for mainstream affordable housing programs. In response, JPA participants have argued that setting too deep an affordability threshold would limit the number of transactions that would be feasible and have pointed to the powerful long-term deepening of affordability over time as rent-restricted units enjoy price stabilized rents while market-rate rents rise due to cost escalation.

2. **The fees generated from these projects may be overly high.**
   Many parties are compensated for their role in JPA-owned middle-income housing; critics contend these fees are disproportionate to the underlying risk and time involved. For example, bond issuance fees, which are upfront fees paid to the JPA and other issuance parties (such as underwriters and legal teams) to issue bond debt range from $500,000 to $2.5 million per transaction. Upfront project administrator fees, which are paid to the project administrator, can be $2 million per transaction. In addition, most of these deals are structured to include a series B bond. This is subordinate debt typically sold to the public markets with the project sponsor as the beneficiary. It is typically paid off after tax-exempt bond debt. B bonds have often had a substantially higher interest rate than the tax-exempt bond debt due to their riskier position in the capital stack. In addition, cities can charge ongoing annual host fees to the project. These sometimes compensate cities for monitoring activities, but they also can be charged simply because the project is within that jurisdiction.

   In response, JPA participants point to the novelty and significant complexity of these government-owned and bond-financed transactions and the need to satisfy the potentially intense scrutiny of bond investors, tax auditors and others while still maintaining these properties as performing assets over time.

3. **Aggressive underwriting could lead to projects defaulting on their bonds, potentially triggering the loss of affordability restrictions.**
   Several interviewees expressed concerns that the underwriting for JPA-owned middle-income housing may be overly aggressive and could lead either to future default or leave these projects
with large outstanding debt balances that complicate future recapitalization. For example, loan to value ratios that exceeded 100% and debt service coverage ratios at or below 1.0 were identified in several transactions. Of particular concern, regulatory agreements are typically structured to allow a foreclosure to wipe out affordability restrictions if bonds cannot otherwise be repaid. Complicating matters further, there are no statewide guidelines or oversight related to appropriate underwriting criteria for these projects.

Project proponents point out that these deals are fundamentally different from the traditional affordable housing transactions they are often compared to. JPA-owned middle-income deals, by contrast, must be fully publicly owned and therefore cannot have private parties invest equity and take partial ownership. Instead, project sponsors issue bonds in amounts that may exceed the value of the project, using excess bond proceeds to capitalize large financial and capital reserves, which have a similar function to equity and are drawn against to cover any cash flow shortages in near years. Furthermore, the project administrator has a strong incentive to ensure financial performance: Any drop in net operating income below pro forma levels would most immediately impact payments of asset management fees, as well as payments on the subordinated B Series bonds, which are held by the project administrator.

In addition, these transactions are scrutinized by multiple sophisticated institutional investors, which each must conduct due diligence on the bonds prior to purchase.

In the event of a default, bondholders should be incentivized to renegotiate the project’s total indebtedness in a way that retains the affordability levels so they don’t lose the bond’s income tax exemption.

Agents representing one or more JPAs could be bidding against one another for the same projects, potentially leading to inflated purchase prices.

Another critique of this model is that JPAs may be purchasing projects at inflated prices, which only benefits the seller. Interviewees expressed concern that JPA-authorized buyers may only be able to offer highly competitive bids because they are able to access cheaper capital in the form of tax-exempt bond debt, as well as the property tax exemption. While potentially a valid concern, this also reflects dynamics in the apartment markets prior to recent inflationary trends, in which buyers and investors were assuming historically high returns, and correspondingly low cap rates, on multifamily properties. Of particular note, interviewees report that agents representing one or more JPAs may have been bidding against one another for properties, which could more directly lead to inflated purchase prices. However, at least two of the JPAs report that current policies have been implemented to mitigate or prevent the practice of multiple parties authorized by a single JPA bidding on the same asset.
There is not a strong enforcement mechanism to address affordability breaches, nor is there always a clear party to step in if the asset is struggling financially.

With JPA-owned middle-income housing, there has been neither an equity provider nor sole debt provider who can step in to resolve financial issues as would be the case for a conventional market rate or affordable multifamily property. Instead, in the event of a default, bondholders must create a committee and appoint a trustee to intervene, potentially delaying and complicating resolution. Unlike traditional affordable housing projects, JPA-owned middle-income housing uses a governmental property tax exemption, as opposed to a welfare property tax exemption, so it is only the bond income tax exemption that is most immediately at risk if affordability is not maintained. In addition, there is no equity investor who has skin in the game. To a certain degree, that role is played by the project administrator, who is motivated to retain the value of the subordinated Series B Bonds. But the only entity with true ownership interest is the JPA, which is also responsible for monitoring compliance. The JPA has no legal obligation nor financial incentive to invest into the property. If the affordability requirements are breached, bondholders must rely on the JPA or its asset management company to disclose that fact, and then they must choose how to intervene to correct the situation.
Principles for Strengthening the JPA Model

The concerns above suggest that more formal state oversight of JPA-owned middle-income housing is warranted, alongside establishment of key guardrails for JPA projects. The JPA model holds tremendous promise and is likely to continue to scale across the state, both as an acquisition and preservation tool and potentially as a tool for spurring new construction. To that end, we recommend the following general principles:

**Stronger affordability terms**

JPA-owned middle-income housing should be subject to a minimum standard of affordability terms and requirements. This could include codifying a requirement for long-term deed restrictions that go beyond the term of the bond financing. It could also mean ensuring meaningful affordability below market-rate rents for the subset of units specifically targeting low-income tenants at or below 80% of AMI. For acquisitions, a requirement for non-displacement clauses should be codified to ensure no tenants are evicted as a result of the transaction. There should also be a regulated standard codified to cap rent growth.

**Capped transaction and operating fees**

The fees generated by the key parties that control the transaction — the city, the JPA and the project administrator — should be limited to reasonable amounts that still properly incentivize the parties for their involvement in the transaction. While high fees may have been warranted as the program was initially launched, these fees should be appropriately lowered to better reflect underlying risk and to create more economic headroom for reduced rents.

**Increased state oversight**

The state should conduct a deeper analysis of the JPA model to ensure that proper use and sufficient public benefit result from its growth and to inform strategies for long-term oversight of the program. The state should also evaluate a broader oversight role, authorizing, affirming and auditing the programs and policies of individuals JPAs working in the state. For example, this could include review of each JPA’s underwriting and reserve standards to ensure that the underlying soundness of transactions initiated under this model is reasonable.

**Processes to ensure that JPAs are not bidding against one another**

Each JPA should put in place processes and procedures to ensure that they do not have multiple agents under their control bidding on the same asset. In the longer run, the state should consider
licensing one JPA to operate as the sole provider of this model in each region of the state.

**Increased transparency and stronger enforcement mechanisms**

The state should ensure that existing public data on each JPA transaction, including ongoing monitoring information, is being tracked in a common format and reported in a coordinated fashion so that the model can be readily evaluated and independently monitored over time. In addition, there should be financial penalties for those project administrators that fail to maintain affordability restrictions.

**Lower barriers to entry**

To date, the preponderance of JPA-owned middle-income housing has been moved forward by just three JPAs, and just two project administrators have been retained in the large majority of projects. While that is not necessarily unusual for a new program that requires a very high level of financial complexity, there is an opportunity for the state to provide technical assistance both to help new JPAs enter this space and to enable smaller and potentially more diverse real estate companies to become project administrators. Additionally, the state may wish to consider technical assistance investments to aid cities and counties to more effectively understand and use this model to benefit the distinct needs of their communities.
Conclusion

JPA-owned projects have the potential to create significant amounts of new deed-restricted middle-income housing — both through acquisitions and new construction — via targeted tax incentives. The model is scalable, and public entities ranging from CalHFA to the newly formed Bay Area Housing Finance Agency to HEART of San Mateo County are already exploring whether this model could be a tool to help them create and/or preserve much-needed affordable housing. However, guardrails are needed to ensure that the benefits provided by JPA-owned middle-income housing is commensurate with foregone public revenue. California’s Assembly Bill 1850 (Ward) may offer an important first step for achieving these goals, but further work is needed over the next several years to better assess and oversee the long-term implementation of this model. The state’s persistently stubborn under-production of affordable housing demands bigger and bolder ideas, and JPA-owned middle-income housing should serve as one important tool in the toolbox.
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