

# SUPPLEMENTAL

COUNCIL AGENDA: 12-9-08  
ITEM: 5.2

## Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Leslye Krutko

**SUBJECT:** CITYWIDE INCLUSIONARY  
HOUSING ORDINANCE –  
SECOND SUPPLEMENTAL  
REPORT

**DATE:** November 26, 2008

Approved

Date

11-26-08

**COUNCIL DISTRICT:** Citywide  
**SNI AREA:** All

### SUPPLEMENTAL

#### REASON FOR SECOND SUPPLEMENTAL REPORT

On November 14<sup>th</sup>, the Housing Department released a recommendation on a Citywide inclusionary housing program to the Community and Economic Development Committee and the Neighborhood Services and Education Committee. Since that time, the Department has continued to receive valuable feedback on this issue, which has resulted in modifications to the Department's recommendations. Additionally, certain questions were posed at the Council's November 10<sup>th</sup> Special Meeting. This second supplemental memorandum sets forth the Housing Department's revised recommendation and responds to those questions raised at the Special Council Meeting.

#### RECOMMENDATION

It is recommended that the City Council approve staff's revised policy recommendation contained herein to serve as the basis for adoption of an ordinance for an inclusionary housing requirement on residential development Citywide.

#### EXECUTIVE SUMMARY

Over the past year and a half, City staff has been reviewing a potential Citywide inclusionary housing ordinance. After significant outreach and discussion, the staff released policy recommendations for Council consideration on November 14, 2008. Since that time, a series of meetings have taken place to discuss those recommendations and obtain input and suggestions for improvements.

This memorandum updates the policy recommendations released earlier to respond to the comments received. Additionally, the memo responds to several questions that were asked during the process.

## **BACKGROUND**

Since the November 10, 2008 City Council meeting, where the Council considered the timeline for discussion of a potential Citywide inclusionary housing program, the Housing Department has continued to hold stakeholder and community meetings on the subject. On November 14, 2008, City staff released policy recommendations detailing the main components of a potential ordinance. Since that time, public testimony has been given at meetings of the two Council Committees, the Planning Commission, the Housing and Community Development Advisory Commission, and two public meetings. Two additional public meetings are scheduled for the week of December 1<sup>st</sup>.

Based on this additional input, the Department is now recommending certain modifications to its original recommendation. The most significant of these revised recommendations are:

- (1) On-site Unit Development— Concerns were expressed about social integration, and the desire to integrate affordable units in market rate developments. Additionally, concern was expressed about dispersing affordable housing throughout the City. This concern was expressed by a number of stakeholders, but was of most concern to neighborhood representatives who attended the public meetings.

Based on the input received, the Housing Department is recommending that the policy provide incentives to developers to develop units on site rather than selecting an alternative compliance option in an effort to achieve socio-economic integration and to disburse affordable units throughout the community. The relevant policy recommendations include:

- (a) A reduction in the percentage of units required to be affordable from 20% to 15% if a developer agrees to produce the units on site. (Note: if the developer opts to accept an alternative compliance option, there would be a 20% requirement.)
  - (b) The availability of offsets that are only available to projects that agree to integrate the units on-site— including expedited review, technical assistance, reduced parking requirements, and altered setbacks.
- (2) Operative Date of the Ordinance— Concerns were expressed about whether the definition of operative date accounted for a return to a respectable housing market. Based on discussions, we are recommending changes that include:
  - (a) A change from 2,000 units to 2,500 units for the threshold of building permits issued to more accurately reflect a recovering market.

- (b) More than 50% of these units (or 1,250) must be outside of the North San Jose Planning Area.
  - (c) A date certain of January 1, 2012 in the event that the market continues at a lower production level for an ongoing time period.
- (3) Grandfathering/Pipeline— Some concerns were raised about the timeline for submittal of planning applications and the unique issues surrounding large master-planned developments. Additionally, concerns were raised about the definition of “substantially complete” as it relates to planning submittals. At the same time, others were concerned that the pipeline definition not be so broad as to capture a significant portion of future development. To respond, we are recommending the following changes:
- a. Initial Application Date—Changed the first date from three months to six months to provide additional time for submittal of the initial planning application.
  - b. Added large planning areas—Added language that provides, in limited circumstances, relief from the requirements for larger phased developments in master-planned communities.
  - c. Definition of “Substantially Complete”—Staff is working on a definition that will clearly define the phrase “substantially complete” so that both the development community and the City will be clear what is required to meet this standard.
- (4) In Lieu-Fee—Concerns were raised about the need to differentiate between rental and for-sale housing, and to ensure that one tenure is not impacted unfairly, thereby unintentionally providing incentives to build one over the other. Additionally, concerns were raised that there be parity between alternative compliance options so that one option is not always the favored one. It is therefore important to ensure that the in-lieu fee is set at a rate that makes it a choice for developers, but not the choice because it is set too low. It is critical to the success of the ordinance to set the fee at an appropriate level.

Based on discussions, we are recommending the following changes:

- (a) Rental Housing—for rental housing, the fee will be the same as the fee proposed in the original staff report-- the average per unit City subsidy required for affordable new construction rental housing development in the prior year.
- (b) Ownership Housing— for for-sale housing, the fee will be based on the “affordability gap,” or the gap between the cost of constructing the unit and the revenue collected from selling or renting the unit at the affordable sales price or rent.
- (c) High-Rise Housing—For high-rise housing in the downtown, the fees for rental and ownership housing will be reduced by half, consistent with current Council direction, until 2,500 units have been permitted. At that time, an evaluation will be completed of the market downtown, and a determination will be made regarding the continued need for this fee reduction.

Additionally, certain questions were posed at the Council's Study Session on November 10<sup>th</sup>. This supplemental memorandum responds to those questions.

## **ANALYSIS**

### **Amended Guiding Principles**

Feedback from recent outreach efforts has emphasized that housing development takes place in the context of existing neighborhoods and communities. Consequently, the Department believes that the Guiding Principles need to be expanded in recognition of this fact, as follows:

- **Simplicity** – An inclusionary housing policy should be easy for residents, neighborhoods, affordable housing advocates, and developers to understand and for the City to administer.
- **Flexibility** – An inclusionary housing policy should give developers as many alternatives as possible for compliance.
- **Consistency and Fairness** – Affordable housing units should be disbursed throughout the community and all developers should be treated equally, particularly with respect to projects in the pipeline. Any ordinance should be Citywide, and not located in only parts of the City, to ensure that all developments have the same requirements.
- **Certainty** – Developers, neighborhoods, affordable housing advocates, and the City should have advanced knowledge of what the impacts and outcomes will be with an inclusionary housing policy. The rules and process of the inclusionary housing policy should be clearly defined, particularly with respect to the rules for allowing alternatives and offsets that could have impacts on surrounding neighborhoods.

### **Goals for an Inclusionary Housing Program**

As a result of feedback received, we have developed additional clarity about the recommended inclusionary housing program and the goals it is intended to accomplish. The fundamental goals are:

- Increasing the supply of rental housing affordable to lower-income families in San Jose.
- Increasing and promoting homeownership opportunities and choices for moderate-income families.
- Disbursing affordable housing throughout the community in mixed-income neighborhoods.
- Providing housing for San Jose's workforce.

### **Additional Information**

During the course of outreach, several questions have been raised. This report includes the following attachments that respond to these questions:

- (1) **Attachment F**—Statistics about past and projected housing production in San Jose.
- (2) **Attachment G**—A map of Santa Clara County and adjacent counties that shows the communities that have adopted inclusionary programs and policies.
- (3) **Attachment H**—Responses to specific questions that were raised at the November 10, 2008 City Council Special Meeting.

**Revised Policy Recommendations**

The table below shows the Housing Department’s revised policy recommendation for a Citywide Inclusionary Housing Ordinance (with changes shown as deletions or additions) and the reasons for the specific revisions:

<b><u>On-Site Inclusionary Requirements</u></b>		
<b><u>Issue</u></b>	<b><u>Recommendation</u></b>	<b><u>Rationale</u></b>
Geographic Applicability	<p><b>Geographic</b> – Ordinance requirements will apply to all residential development citywide, including redevelopment areas.</p> <p><b>Building Types</b> – Ordinance requirements will apply to new construction and adaptive re-use (but not to acquisition/rehabilitation).</p>	<p>Meets the guiding principles of fairness and consistency, and certainty. A developer working outside of a <u>redevelopment project</u> area will have the same requirements as a developer working in an <u>RdA project</u> area.</p> <p><u>This parallels the current RdA program.</u></p>
Percent Set Aside and Income Targeting Requirement	<p><b>Rental</b>—Developer chooses one of <u>two</u> options: <del>20% or 15%</del> , with <u>6% very low-income and 9% low-income, for units developed on-site; or 20%, with 8% very low-income and 12% low-income, for units developed off-site, depending on depth of affordability.</u></p> <p><b>For-Sale</b>—Developer chooses one of <u>two</u> options: <del>20% or 15% moderate-income for units developed on-site; or 20% off-site with either 20% moderate-income with for-sale units or 8% very low-income and 12% low-income for rental units for units developed off site depending on depth of affordability.</del></p>	<p><del>Meets goal of flexibility, and provides options for increased affordability.</del></p> <p><del>Meets goal of flexibility, and provides options for increased affordability.</del></p> <p><u>This provides an incentive for the developer to provide the affordable units on-site.</u></p>
Partial Units	When an inclusionary obligation results in a fractional unit greater than 0.5, the obligation will be rounded up. The developer can choose to provide the unit or pay the pro rata in-lieu fee for the fractional unit.	Allowing developers to address inclusionary obligations of fractional units by paying a pro rata in lieu fee or providing a full unit if the fraction is 0.5 or above provides more flexibility for developers while ensuring that the Ordinance’s affordable housing goals are met.
Threshold	Ordinance requirements will apply to developments with 11 or more units.	Applying the inclusionary requirements only to developments of 11 or more units is

<u>On-Site Inclusionary Requirements</u>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
		consistent with current RdA policy. It exempts smaller developments, for which complying with inclusionary obligations may not be economically feasible. <u>A review of threshold requirements of large and mid-sized cities including Boston, Chicago, Denver, San Diego, San Francisco and Sacramento shows that five out of the six cities reviewed have threshold requirements that are below 11 units ranging from 2 to 10 units with Denver's threshold set at thirty. If the threshold is set too high, a developer may avoid the ordinance by building one less unit, as is the experience in Denver where many 29-unit developments were submitted.</u>
Term of Affordability	Rental: Inclusionary units must remain affordable for 55 years. Owner: Inclusionary units must remain affordable for 45 years (the restriction can be removed with an equity-share buyout at the time of re-sale).	Requiring a 45-year affordability term for ownership units and a 55-year term for rental units is consistent with minimum Redevelopment Law requirements. The units will therefore be counted towards the City's affordable housing production requirements.
Type of Resale Restriction for Ownership Units	Inclusionary ownership units must contain a shared-equity provision.	A shared equity provision allows the original buyer of an affordable unit to sell the unit at the market price and earn a portion of the appreciation of the home. Upon resale, the City recaptures the difference between the market price and the affordable price of the unit plus a portion of the appreciation. The City then uses these funds to assist another buyer to purchase a home anywhere in the City. This provision is consistent with current RdA policy and provides for more choice and flexibility for homebuyers. It also may make it easier to find willing buyers of affordable units, as they have the opportunity to earn equity upon resale of the unit.
Operative Date of Ordinance	Ordinance takes effect <u>after the customary time of 30 days after final adoption, but does not become operative until</u> the later of: (1) January 1, 2010, or (2) the first day of the month following the first 12-month consecutive period in which building permits for <del>2,000</del> <u>2,500 units</u> have been issued, as certified by the Housing	By tying the Ordinance's operative date to building permit activity, this provision allows the market to recover to a certain level before the inclusionary requirement is imposed. Over the last <del>20</del> <u>28</u> years, the number of building permits has fallen under <del>2,000</del> <u>2,500</u> <del>ten</del> <u>three times</u> and

<u>On-Site Inclusionary Requirements</u>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	<p>Department Director or his/her designee (no more than 50% of the 2,500 permitted units can be in the North San Jose Planning Area), or no later than the date certain of January 01, 2012.</p>	<p><u>captures periods both of economic decline and periods of recovery when economic conditions have improved, and this correlates with down economic periods in the City.</u> This delayed operative date will provide sufficient time for developers to adjust their financial and development assumptions to accommodate the Ordinance's requirements. <u>The limitation on where the 2,500 units with building permits are to be built is intended to ensure that there is a broad recovery from the current downturn in the housing market.</u> Based on current Planning Department projections, it is anticipated that 2,500 building permits will be issued in the 2011/2012 fiscal year. Therefore, we are recommending a time-certain date for implementation of January 1, 2012.</p>
Grandfathering/Pipeline	<p>Developers meeting the following requirements will be exempt from the requirements of the Ordinance:</p> <ul style="list-style-type: none"> <li>a) Within <del>three</del> six months of the effective date of the ordinance, the developer submits an applications for a planning permit (CUP, site development, or PD permit) and environmental clearance that are deemed substantially complete by the City pursuant to the provisions of the Zoning Ordinance and the Environmental Clearance Ordinance, and</li> <li>b) Within twenty-one months after the effective date of the ordinance, the developer receives an approved planning permit; and</li> <li>c) Within twenty-seven months after the effective date of the ordinance, the developer receives an approved building permit.</li> <li>d) If building permits are allowed to expire without construction of the project, the development will no longer be exempt from the ordinance.</li> </ul> <p><u>Developments in specific planned areas, as defined by the Planning Department, and that don't include Redevelopment Project Areas within their boundaries (which are already</u></p>	<p>By exempting from inclusionary requirements those developments that have already invested time and resources into planning and predevelopment and that demonstrate continuous progress toward entitlement and permitting, the Ordinance promotes fairness for those developments currently in the pipeline. It also ensures that those exempt developments are verifiably in the development process.</p> <p><u>Developers of large, phased projects have invested funds in planning, and they should be able to lock in development costs and pricing for all phases to be exempt from the inclusionary ordinance if the phases</u></p>

<u>On-Site Inclusionary Requirements</u>		
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	<p><u>subject to an inclusionary requirement) will be exempt from the requirements of the ordinance if phased developments, the development has a substantially completed PD zoning application on file at the time of the effective date of the ordinance. In addition the development must demonstrate ongoing progress in order to maintain the exemption. the above timelines apply to the first phase; each subsequent phase must obtain building permits within two years after the issuance of permits for the prior phase.</u></p> <p><u>These times will be extended by the amount of time necessary to resolve delays imposed by non-City environmental or other regulatory agencies.</u></p> <p><u>Upon passage of the ordinance, developments under the current RqA inclusionary policy may opt to participate with requirements consistent with the Citywide ordinance as long as Building Permits have not been issued.</u></p>	<p><u>continue to be built according to a reasonable schedule. It is unknown how many developments may qualify under this definition and would be in a position to submit a substantially complete application by the effective date of the ordinance. Per the suggested language, it is likely that this language would only apply to Communications Hill, where an estimated 2,300 units are planned and would result in a potential loss of between 345 and 460 affordable units.</u></p> <p><u>This exception would provide relief in cases where delays are outside the control of either the developer or the City.</u></p> <p><u>This will provide additional flexibility to pipeline projects located in redevelopment project areas.</u></p>
Pressure Relief Valve	<p>When the gap between the market price and the calculated affordable price for homeownership units <u>targeting the lowest area median income (AMI) is within 5% \$10,000 or less</u>, the developer is entitled to relief from his/her inclusionary obligation upon certification to the Housing Department of market prices in his/her development. <u>The following requirements will apply provisions constitute the form of that partial relief:</u></p> <ol style="list-style-type: none"> <li>1. <u>The home must be sold to the first buyer at the restricted price</u></li> <li>2. No equity share provision will be required.</li> <li>3. <u>The unit must be owner-occupied .</u></li> <li>4. No income verification of the buyer will be required.</li> <li>5. Developer must <u>re-certify</u> that the relief is needed every six months.</li> </ol>	<p>This provision allows the Ordinance to adjust to periods of demonstrated economic distress in the development community, promoting fairness for developers.</p>

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	<p><u>A Developer may select an alternative compliance option as long as he/she meets specific criteria that defines the parameters under which these option may be executed. A developer choosing any alternative compliance option will be subject to meeting the 20% set aside requirement, including the in lieu fee option. Specific criteria will be developed that define the parameters under which these options may be exercised. Alternatives must be balanced and equitable so that developers are not selecting alternatives because the one alternative is much less expensive and therefore no on-site units are produced. For example, if the in-lieu fee is set too low, all developers will choose that option.</u></p>	<p><u>The Ordinance provides developers with alternative compliance options for meeting their inclusionary obligation in ways other than providing affordable units on-site. The set aside requirement will increase from 15% to 20% to provide an incentive for developers to build on site.</u></p> <p><u>The Ordinance provides for cost-saving offsets for developers that meet their inclusionary requirement by providing affordable units on-site. These offsets will decrease costs for developers and provide an incentive for on-site development of the affordable units, thus increasing the economic integration of developments and neighborhoods.</u></p>
Off-Site Construction	<p><u>A developer may build affordable inclusionary units off-site, with limitations placed on the off-site location options. The off-site must be located within the same planning area as the market rate units or in an adjacent planning area. The site must be approved. Approval will be granted if the off-site location is demonstrated to be consistent with City policies or if the developer may partners with an experienced affordable housing provider.</u></p>	<p><u>Off-site construction may be a good option, and can often result in more deeply affordable units. However, to ensure that units are dispersed through out the city, the off site must be located within the same planning area or an adjacent planning area to avoid over concentrating or clustering units in low-income neighborhoods. Additionally, a separate and distinct project can apply for affordable housing subsidies that can make a project more economically feasible.</u></p>
Credit Trading or Credit Transfer -- <u>General</u>	<p><u>Developers may transfer and/or trade inclusionary unit credits to pool together and build larger affordable projects off-site.</u></p>	<p><u>Some developers have only a small requirement and would benefit by “buying” credits from another developer. Other developers may have the ability to build additional units and would benefit by “selling” units to a developer who needs to meet an inclusionary requirement.</u></p>
<u>Credits for Housing Preservation</u>	<p><u>An owner of a multi-family project that is subject to a HUD restriction that expires after the date of the ordinance takes effect can receive a credit for one future inclusionary unit for every five HUD contract units that the owner agrees to maintain at affordable levels for as long as HUD provides subsidies, but no less than five years. This benefit is not transferable from the owner to another developer.</u></p>	<p><u>This will incentivize owners of HUD-subsidized units to keep the units affordable.</u></p>

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
In Lieu Fee	<p><u>Rental Housing</u>-- The per unit in-lieu fee amount will equal the average per unit City subsidy required for affordable new construction rental housing development in the prior year.</p> <p><u>Ownership Housing</u>—The per unit in-lieu fee amount will equal the <u>“affordability gap,” or the gap between the cost of constructing the unit and the revenue collected from selling the unit at the affordable sales price.</u></p> <p><u>High-Rise Housing</u>—The per unit in-lieu fee for high-rise housing in the downtown will be reduced consistent with current Council direction, until <u>2,500 units have been permitted. At that time, an evaluation will be completed of the market, and a determination will be made regarding the continued need for this fee reduction.</u></p> <p>The City will use the in-lieu fees to provide funding for:</p> <ul style="list-style-type: none"> <li>a) at least 30% of the funds collected will be used to develop housing for households earning at or below 30% of the AMI;</li> <li>b) cover reasonable administrative or related expenses associated with the administration of the ordinance, including funding <u>for staff to implement expedited permit streamlined planning review.</u></li> </ul>	<p>In order to meet legal requirements, an in-lieu fee must have a rational basis. In the past, the RdA program has used a calculation that relates to the cost of subsidizing a like unit. Because it is most likely that the City will use in-lieu fees to subsidize rental unit construction, it follows that the in-lieu fee for rental housing should be equivalent to the subsidy required by the City to finance an affordable rental unit. <u>Because the City does not typically subsidize the construction of for-sale units, the in-lieu fee option should represent the amount needed to replace the unit without assuming any subsidy.</u></p> <p><u>The current RdA inclusionary program provides a lower in-lieu fee for Downtown high-rise development until permits for the first 2,500 high-rise units have been issued. At the present time, permits for 864 high-rise units have been issued, leaving 1,636 units remaining under the 2,500-unit policy</u></p> <p>A priority for the expenditure of funds received through the payment of in-lieu fees should be to assist ELI units. To facilitate <u>and compensate the Planning Department for providing expedited review special handling</u> of those developments that choose to integrate the units in their development, the use of a small amount of in-lieu fees would be used to pay for City staff assigned to this function.</p> <p><u>It is recommended that the in lieu fee be paid at the time of building permit because of compliance and enforcement concerns.</u></p>
Land Dedication	<p>The developer may provide developable land instead of providing units on-site if the site is suitable for residential development and the land value is sufficient to meet the inclusionary requirement <u>without additional City funding.</u></p>	<p>In some situations, land dedication can be a favorable alternative and should be an option.</p>

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
Acquisition and Rehabilitation	The developer may comply with the inclusionary obligation by acquiring and rehabilitating market-rate <u>apartment</u> units and converting them to affordable units. Developer must meet <u>requirements that are stated in the administrative rules and regulations ordinance</u> for the timing of <u>commencement of rehabilitation work</u> and completion of the rehabilitated units. Developers who acquire and rehabilitate existing housing units and market the units with deeded affordability restrictions shall receive one future inclusionary credit for every four units rehabilitated.	While the City needs new construction of affordable housing, it is also important to maintain the existing housing stock. By acquiring and rehabilitating market-rate development and restricting rents, the results include an increase in affordable housing opportunities and neighborhood improvement.  However, since these units do not count one-for-one toward the City's housing goals ( <u>according to the State Department of Housing and Community Development</u> ), it is appropriate that a developer be required to acquire and rehab four units for every inclusionary unit required.
Combination	The developer may comply by combining alternative compliance options.	The City and Redevelopment Agency have found, in the implementation of the current RdA policy, that at times a combination of options is desirable. This will also reduce the potential to revise the ordinance each time a new situation presents.

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
The following offsets will be offered to developers who meet their inclusionary obligation by providing affordable units on the same site as the market rate development:		
Density Bonus	The developer that provides the affordable units on-site may receive a density bonus equal to the percentage set aside required by the Ordinance, provided it is consistent with State density bonus law.	Density bonuses are required by State law. While the City is proactive in supporting the highest possible densities, <u>this is an offset that is encouraged to be utilized by developers.</u>
Reduction in Minimum Parking Space Requirements for Affordable Units	With the approval of the Planning Department Director, a development that provides the affordable units on-site may be granted reduced parking requirements for the affordable units.	<u>Parking reductions are strongly encouraged for developments in proximity to transit and/or in combination with Ecopasses or car-sharing being made available to residents. Reductions in parking can reduce construction costs.</u>
Altered Setback Requirements	With the approval of the Planning Department Director, a development that provides the affordable units on-site may be granted altered setback requirements for the affordable units.	<u>Setback requirements address neighborhood character and modifications may be appropriate on a case-by-case basis. Reduced setbacks may provide for the construction of additional affordable units.</u>

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
Alternative Product Type	Provided the affordable units are provided on-site and have the same bedroom count distribution as the market rate units, developers may provide affordable units that are a different product type than the development's market rate units.	This option allows the most flexibility for developers, particularly those who are building a high cost, low-density product.
Alternative Interior Design Standards	Provided the affordable units are provided on-site and have the same bedroom count distribution as the market rate units, the affordable units may use different interior design, appliances and materials than the market rate units.	Different interior design works well for for-sale housing, and less well for rental housing. Nevertheless, as long as the materials used are of good quality, one way of achieving affordability is by reducing high-cost interior finishes.
Expedited Review	A development that provides the affordable units on-site will be offered an expedited review process.	We heard many times that time is money. With this recommendation, developers who choose the on-site option would get <u>expedited review with mutually agreed upon milestones for performance both for the City and the developer.</u>
Technical Assistance	A development that provides the affordable units on-site will be offered technical assistance, including assistance with the development review process, financing alternatives, and selling/renting the affordable units to qualified buyers/tenants.	The City will provide additional technical assistance to any developer choosing to incorporate the units on site. This encourages developers to do so, furthering the City's goal of economic integration.
Financial Subsidies	The developer may apply for financial subsidies for the affordable units from federal and state funding sources. The developer may apply for City financial subsidy if demonstrated that more units or deeper affordability will be achieved than is required under the Ordinance.	Some cities do not allow inclusionary projects to apply for other sources of government money. Based on feedback received, we are recommending that this be allowed, even though the projects would conceivably compete with City-subsidized developments.  In an effort to increase ELI construction, the City will provide a partial subsidy to developers who agree to reduce rents to lower than required levels.
<b>Off sets currently offered to Rental Developments only</b>		
Park Fee Exemption	Rental units that are affordable to households earning less than 60 percent of area median income (AMI) are exempt from paying the Park Fee.	This is current City policy <u>and because of the income criteria, it applies only to rental projects.</u> No change is recommended at this time <u>because the policy is under separate review.</u>
Property Tax Exemption	Developers who partner with nonprofit housing developers and provide rental	This is current law, <u>and because of the income criteria, it applies only to rental</u>

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	units affordable to households earning less than 80 percent of AMI are exempt from paying property taxes, provided the nonprofit meets the standards set forth in the California Revenue and Taxation Code Section 214 and has “material participation” and “substantial management duties” in the project, as defined in the California Board of Equalization Rule 140.1.	<u>projects. The property tax exemption applies only to properties built by nonprofit developers.</u>
Construction Tax Exemption	Rental units that are affordable to households earning at or below 50 percent of AMI are exempt from paying the Building and Structure Construction Tax, the Construction portion of the Construction and Conveyance Tax, the Commercial-Residential Mobilehome Park Building Tax, and the Residential Construction Tax.	This is current City policy. <u>Because of the income criteria, it applies only to rental projects.</u> No change is recommended at this time.

**POLICY ALTERNATIVES**

In reaching the recommendations spelled out above, the following alternatives were also considered:

**Alternative #1:** *Do not expand inclusionary housing requirements beyond redevelopment project areas.*

**Pros:** The City’s current efforts, including its financial assistance programs and the RdA inclusionary requirement, are producing a significant number of affordable units. Expanding the program would require additional administrative efforts. This is the wrong time to implement such an effort because the economy is at its lowest point in decades.

**Cons:** Despite the City’s efforts, a large number of San Jose residents do not have adequate or affordable housing. Additionally, the City’s 20% funds are limited, and will not allow the level of past production or meet the future production needed. The recommendation recognizes the current market conditions, and waits until the market has stabilized before developers are required to comply.

**Reason for not recommending:** The City Council has directed the Housing Department to return with a proposal that expands inclusionary housing requirements beyond redevelopment areas based on the City’s need to have all the tools in the toolbox to address the affordable housing crisis. Inclusionary housing programs are used by the majority of cities in Santa Clara County and by neighboring cities and counties in Santa Cruz, San Mateo, and Alameda Counties.

**Alternative #2:** *Adopt a Citywide inclusionary housing program with different detailed requirements than those recommended by staff.*

**Pros:** The City Council may prefer certain options over others for a variety of reasons. While there are dozens of inclusionary programs in the Bay Area, they are all different, so there is no right or wrong programmatic design.

**Cons:** City and Redevelopment Agency staff have spent a great deal of time researching effective inclusionary programs and meeting with developer and advocate stakeholders. The recommendations included in this memo take into account what we heard during those one-on-one and public meetings.

**Reason for not recommending:** The recommendations represent a thoughtful effort to respond to concerns raised by stakeholders and to implement the four Guiding Principles.

### PUBLIC OUTREACH/INTEREST

- Criteria 1:** *Requires Council action on the use of public funds equal to \$1 million or greater. (Required: Website Posting)*
- Criteria 2:** *Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. (Required: E-mail and Website Posting)*
- Criteria 3:** *Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. (Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)*

The recommended action meets the Criteria #2 above. E-mail notification of the City Council meeting will be sent to the Department's list serve of over 700 names and this report will be posted to the City's website.

Other public outreach efforts have included the following:

January – March 2008	Three developer stakeholder meetings with the consultant preparing the economic feasibility analysis of inclusionary housing.
May – June 2008	Four open public forums throughout the City to share the results of the economic feasibility analysis.
August – October 2008	35 one-on-one meetings with developers, other business interests and affordable housing advocates.
September 2008	One stakeholder meeting of affordable housing advocates.

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September – October 2008	Two stakeholder meetings of developers and related business interests.
October – December 2008	Eight open public forums throughout the City to discuss potential parameters of a Citywide inclusionary housing policy.
June-November 2008	Twelve City Council Commission and Committee meetings where inclusionary housing was discussed.

### **COORDINATION**

Preparation of this memorandum was coordinated with the Department of Planning, Building and Code Enforcement, the Redevelopment Agency, and the Office of the City Attorney.

### **CEQA**

CEQA: EIR Resolution No. 65459 and Addendum thereto, PP08-258

  
**LESLYE KRUTKO**  
Director of Housing

#### Attachments:

Attachment F—Analysis of Past and Future Housing Production and Inclusionary Production

Attachment G—Map of Inclusionary Housing

Attachment H—Questions Raised at the November 10<sup>th</sup> Special City Council Meeting

For questions, please contact Leslye Krutko, Director of Housing, at 535-3851

## ATTACHMENT F

### Analysis of Past and Future Housing Production and Inclusionary Production

In the 20 years since the City Council created the Housing Department, more than 17,000 affordable housing units have been added to the City's housing inventory. This attachment looks at data regarding this production, covering calendar years 1999 through 2008 (through September), as listed here:

- (1) Table 1-- Production broken down by affordable and market rate;
- (2) Table 2-- Production broken down by projects inside project areas where inclusionary requirements are currently in place and outside project areas where they are not;
- (3) Table 3-- The same information included in #2 above, but further broken down by affordable and market rate;

Additionally, this attachment looks at future anticipated production, covering calendar years 2008 through 2012, as listed here:

- (1) Table 4—Forecast of Total Housing Production (as originally projected by the Planning, Building and Code Enforcement Department);
- (2) Table 5—Forecast of Total Housing Production (as revised based on current projections).

**TABLE 1**  
**Total Building Permits Issued for Housing in San Jose**  
**Broken Down by Affordable and Market Rate\***

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008**	TOTALS
<b>Total Permits</b>	3,606	4,459	3,369	2,484	4,329	2,977	2,782	2,973	2,170	1,118	30,267
<b>Affordable</b>	687	796	978	1,230	956	830	451	763	245	199	7,135***
<b>Market</b>	2,919	3,663	2,391	1,254	3,373	2,147	2,331	2,210	1,925	919	23,132

\* Permit data from the Planning, Building and Code Enforcement Department. Affordable Housing Data from the Housing Department.

\*\* 2008 numbers are through September

\*\*\*This number includes only newly-constructed units.

As illustrated in Table 1, the City issued a total of 30,267 permits over this 9.75 year period, with a high of 3,663 units in the year 2000, and a low of 919 units in the first three-quarters of 2008. Approximately 24% of the permits pulled during this period were for income-restricted affordable units. This translates into an average annual rate of 2,373 building permits for market rate units and 732 permits for affordable units.

**TABLE 2**  
**Total Building Permits Issued for Housing in San Jose**  
**Broken Down by Those Inside and Those Outside of Redevelopment Project Areas\***

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008**	TOTALS
<b>Total Permits</b>	3,606	4,459	3,369	2,484	4,329	2,977	2,782	2,973	2,170	1,118	30,267
<b>Inside Project Areas</b>	1,190	1,687	1,200	1,233	1,696	1,401	1,030	1,589	975	348	12,349
<b>Outside Project Areas</b>	2,416	2,772	2,169	1,251	2,633	1,576	1,752	1,384	1,195	770	17,918

\* Permit data from the Planning, Building and Code Enforcement Department.

\*\* 2008 numbers are through September

Forty-one percent of all permits pulled during this 9.75 year period were in Redevelopment Project Areas where inclusionary requirements were in place.

**TABLE 3**  
**Total Building Permits Issued for Housing in San Jose**  
**Broken Down by Affordable and Market Rate Units Inside and Outside**  
**Redevelopment Project Areas**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008**	TOTALS
<b>Total Permits</b>	3,606	4,459	3,369	2,484	4,329	2,977	2,782	2,973	2,170	1,118	30,267
<b>Affordable (inside)</b>	83	298	293	758	417	587	146	751	245	0	3,578
<b>Affordable (outside)</b>	604	498	685	472	539	243	305	12	0	199	3,557
<b>Market (inside)</b>	1,107	1,389	907	475	1,279	814	884	838	730	348	8,711
<b>Market (outside)</b>	1,812	2,274	1,484	779	2,094	1,333	1,447	1,372	1,195	571	14,421

\* Permit data from the Planning, Building and Code Enforcement Department.

\*\* 2008 numbers are through September

Affordable units are almost equally disbursed between Redevelopment Project Areas and the rest of the City, as shown in Table 3.

Tables 4 and 5 below show the original and the revised production projections from the Planning, Building and Code Enforcement Department for the period of 2008-2012. Due to the current real estate market, the projections have been significantly reduced, from a total six-year production projection of 14,125 units to a new projection of 9,273 units, a 34% reduction.

At this time, we are unable to estimate how many of the projected units will be inside project areas or outside, or how many units will be financed by the City's Housing Department. For 2008, 434 units are expected to be produced in Redevelopment Project Areas, and 199 affordable units (all outside the RdA area) are expected to be produced.

**TABLE 4**  
**Forecast of Total Housing Production 2008-2012**  
**(Original)\***

Calendar Year**	Single Family	% of Total	Multi-Family	% of Total	TOTALS
2008	250	12%	1,875	88%	2,125
2009	375	14%	2,375	86%	2,750
2010	500	15%	2,750	85%	3,250
2011	500	15%	2,750	85%	3,250
2012	375	14%	2,375	86%	2,750
<b>TOTAL</b>	<b>2,000</b>	<b>14%</b>	<b>12,125</b>	<b>86%</b>	<b>14,125</b>

\*Original forecast published in February 2008.

\*\*Forecast from the Planning, Building, and Code Enforcement Department is based on Fiscal Year. For the purposes of this report, the figures are adjusted to provide Calendar Year estimates.

**TABLE 5**  
**Forecast of Total Housing Production 2008-2012**  
**(Revised)\***

<b>Calendar Year**</b>	<b>Single Family</b>	<b>% of Total</b>	<b>Multi-Family</b>	<b>% of Total</b>	<b>Totals</b>
<b>2008</b>	<b>248</b>	<b>19%</b>	<b>1025</b>	<b>81%</b>	<b>1273</b>
<b>2009</b>	<b>250</b>	<b>20%</b>	<b>1000</b>	<b>80%</b>	<b>1250</b>
<b>2010</b>	<b>250</b>	<b>13%</b>	<b>1625</b>	<b>87%</b>	<b>1875</b>
<b>2011</b>	<b>250</b>	<b>11%</b>	<b>2125</b>	<b>89%</b>	<b>2375</b>
<b>2012</b>	<b>250</b>	<b>10%</b>	<b>2250</b>	<b>90%</b>	<b>2500</b>
<b>Total</b>	<b>1248</b>	<b>13%</b>	<b>8025</b>	<b>87%</b>	<b>9273</b>

\*The revised forecast is based on new projections issued by the Planning, Building and Code Enforcement Department at the Development Forecast Meeting on November 19, 2008.

\*\*Forecast from the Planning, Building, and Code Enforcement Department is based on Fiscal Year. For the purposes of this report, the figures are adjusted to provide Calendar Year estimates.

## **ATTACHMENT G**

### **Map of Inclusionary Housing**

The map attached displays four counties (Santa Clara, Alameda, San Mateo and San Francisco), which include 50 cities. Of the 50 cities shown:

- 34 (or 68%) have a citywide inclusionary housing policy
- One city has a partial inclusionary housing policy (San Jose) in Redevelopment Project Areas and some special planning areas
- One city is has a defacto inclusionary housing policy (not an ordinance, but a stated policy in the City's Housing Element)
- 15 cities do not have an inclusionary housing policy.

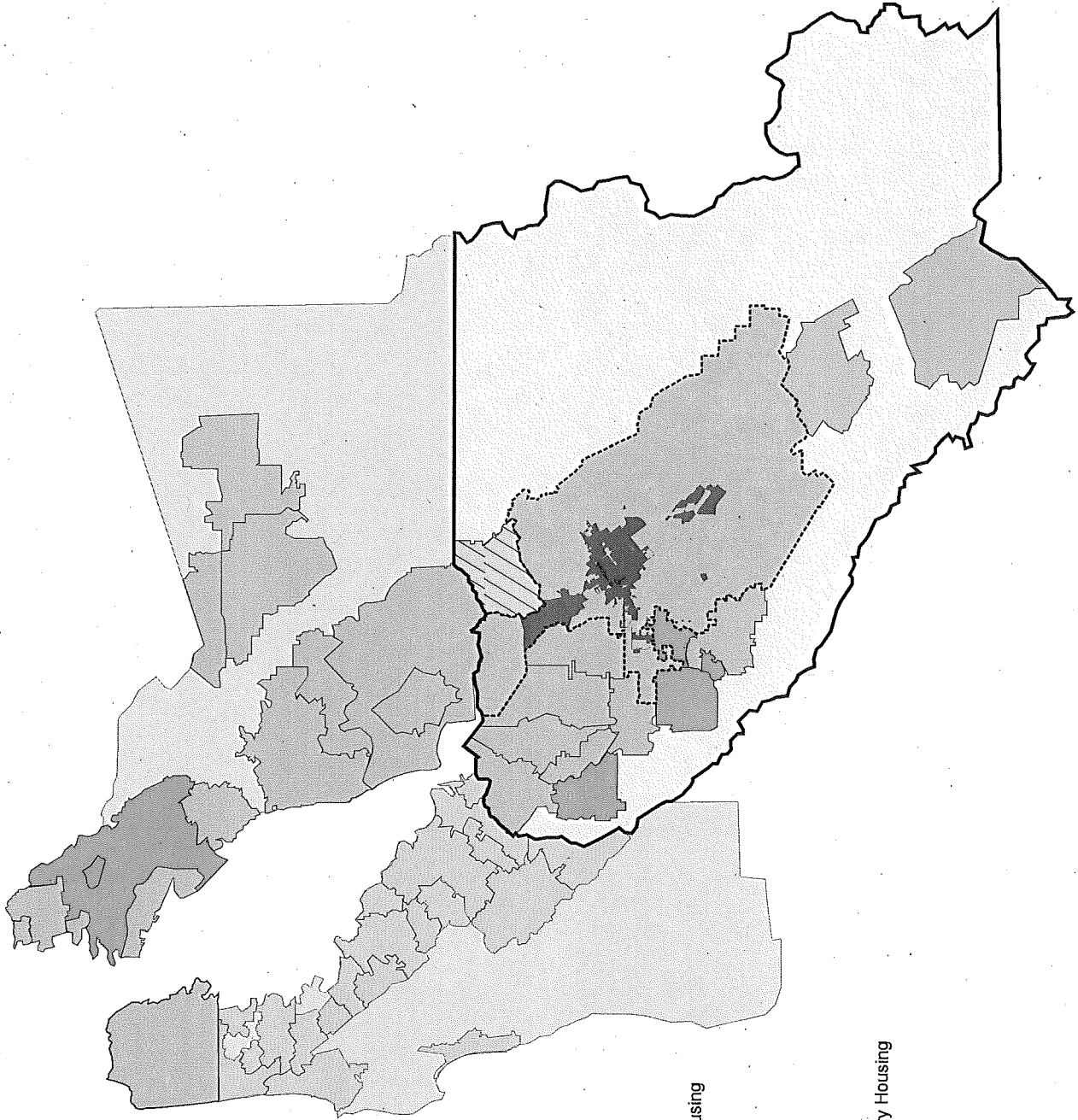
Of the four counties:










- Three have an inclusionary housing policy for unincorporated areas
- One county does not have an inclusionary policy for unincorporated areas (Santa Clara County)

# INCLUSIONARY HOUSING

SANTA CLARA, ALAMEDA, SAN MATEO, & SAN FRANCISCO COUNTIES

- 34 Cities with Citywide Inclusionary Housing
- 1 City with Partial Inclusionary (San Jose)
- 1 City with de facto Inclusionary (Milpitas)
- 14 Cities without Inclusionary Housing
- 3 Counties with Inclusionary Housing
- 1 County without Inclusionary Housing



-  San Jose Jurisdictional Boundary
-  San Jose Redevelopment Project Areas with Inclusionary Housing
-  San Jose Areas without Inclusionary Housing
-  Santa Clara County Jurisdictional Boundary
-  Unincorporated Santa Clara County Areas without Inclusionary Housing
-  Cities with Inclusionary Housing
-  Unincorporated County Areas with Inclusionary Housing
-  Cities without Inclusionary Housing
-  Milpitas with de facto Inclusionary Housing Requirements

## ATTACHMENT H

### Questions Raised at the November 10<sup>th</sup> Study Session

At the November 10<sup>th</sup> Study Session, staff was asked to respond to three questions, one regarding the fiscal impact of a Citywide inclusionary housing program, one about a quotation from the Furman Study, and another about the impact of this policy on Communications Hill. The responses to those questions are set forth below.

#### 1. Fiscal Impact of Proposed Citywide Inclusionary Housing Ordinance

The Citywide inclusionary housing program being recommended will have fiscal impacts on property tax revenues, various construction-related taxes, and parkland in-lieu fees. This analysis applies only to developments newly subject to an inclusionary requirement (i.e., outside of redevelopment project areas and not subsidized by the City's affordable housing program).

For purposes of generating the impact data, it has been assumed that one-third of the inclusionary housing requirement will be integrated into market-rate developments (the "on-site" units), one-third will be built by developers at other locations (the "off-site" units), and one-third of the overall obligation will be satisfied through the payment of an in-lieu fee. Also please note that all dollar amounts are based on tax and fee rates in effect in 2008 and on 2008 construction costs. Finally, the fiscal impact is expressed on the basis of each 500 units since reliable projections of future residential development activity are understandably difficult to make in the current market situation. Those 500 units would generate a total affordable obligation of 92 units under the recommended program (with a 15% requirement for the one-third on-site units, and 20% requirement for the remaining two-thirds).

- a. Property Tax. The property tax is a revenue source for the City's General Fund. Under the welfare tax exemption, rental housing that is restricted to low-/very low-income occupancy and that is operated by a nonprofit entity is exempt from the first one percent of the ad valorem portion of the property tax bill (but not other fees collected by the County on behalf of the City, such as the Sewer Service and Use Charge).

Based on an actual affordable housing project expected to be under construction in the near future (less the additional cost imposed by prevailing wage requirements), that building would owe \$4,391 per unit under the one-percent-of-assessed-valuation formula imposed by Proposition 13 if not subject to the welfare tax exemption. The City's share of that property tax collection is 9%, or \$395 per unit (not including supplemental assessments for debt service).

It is further assumed that the welfare tax exemption will be claimed by all the inclusionary units produced with the in-lieu fee revenue as will all of the rental units produced in off-site projects, and that none of the affordable rental units produced on-site will qualify. For-sale units produced on-site or off-site will also

not qualify for the exemption. For this analysis, it is assumed that 50% of all units produced will be for-sale units.

With these assumptions, 46 inclusionary rental units would be developed (50% of 92), of which approximately 31 (or two-thirds) would be built off-site and therefore qualify for the welfare tax exemption. **As a result, in total, the production of 500 units of housing in areas not now subject to inclusionary or other affordable housing requirements would have an annual \$12,321 impact on the General Fund.**

- b. Construction Taxes. The City imposes four development-impact taxes on new development, including: the Building and Structures Tax; the Commercial, Residential and Mobilehome Park Tax; the Construction Tax; and the Residential Construction Tax. These taxes are collected at the time of building permit issuance and finance transportation and other capital programs. Since 1992, these taxes have been suspended for very low-income units; the suspension will expire on June 30, 2011 unless extended by the City Council.

It is estimated that the total of these four taxes for multi-family rental units of the type typically constructed for very low-income occupancy is approximately \$2,650. It is assumed that all of the units financed by the inclusionary in-lieu fee will be very low-income as well as a portion of the on-site and off-site affordable units built by market-rate developers.

Assuming that 40% of all on-site rental units would be very-low income units (or 6 units) and that 100% of all off-site rental units would be eligible (or 31 units), a total of 37 units would qualify for this exemption. **As a result, in total, it is assumed that 40 out of the 92 affordable units for each 500 units of production will constitute a \$98,050 one-time impact on construction taxes.**

- c. Parkland Impact Fees. The Parkland Dedication Ordinance (PDO) and Parkland Impact Ordinance (PIO) provide that, for residential developments from which the City does not extract a dedication of property, the payment of in-lieu fees. Those fees vary by Multiple Listing Service (MLS) zones to reflect the different prices of undeveloped property by zone. Low- and very low-income units are exempt from the requirements of the PDO/PIO.

It is assumed that the low-/very low-income rental units subject to the Citywide inclusionary housing program and located outside of redevelopment project areas will be located in MLS zones 4, 5, 9, 11 and 12 (generally, the Berryessa, Alum Rock, Downtown, Senter/Monterey and Blossom Valley areas where the majority of anticipated development is projected to occur). A blended rate of PDO/PIO fees based on the anticipated proportion of such units among these MLS zones yields a rate of \$11,853 for apartment units and \$5,163 for single-room occupancy (SRO) units.

All affordable rental units produced under the proposed inclusionary housing program – whether built on-site or off-site, or built using in-lieu fees – will qualify for the exemption from these fees. **In total, it is assumed that 46 out of the 92 affordable units for each 500 units of production will constitute a \$498,623 one-time impact on PDO/PIO fee revenue.**

2. Furman Study: “The Effects of Inclusionary Zoning on Local Housing Markets”

The Furman Center for Real Estate and Urban Policy at the New York University School of Law has published a working paper entitled, “The Effects of Inclusionary Zoning on Local Housing Markets” (November 19, 2007). On page 23 of that paper, there is the following statement:

*“Summing the totals across all 55 [San Francisco Bay Area] jurisdictions with IZ (inclusionary zoning) programs, a total of 9154 affordable units reportedly have been developed as of 2003. Collectively, those 55 jurisdictions issued just under 400,000 building permits between 1980 and 2006, so affordable units produced under IZ are approximately 2.3% of new residential units in this period.”*

While it is factually true that 9154 affordable units is 2.3% of 400,000 total building permits, the statement is misleading because it implies that inclusionary zoning requirements have produced very little in the way of affordable housing. There are several factors which undermine the conclusion reached above.

First, the time periods being compared are not the same. The data for all building permits is through 2006 while the data for affordable unit production is through 2003. Some of the 400,000 building permits must have been issued between 2004 and 2006, three years for which the study does not report on production of affordable units.

Secondly, this statement ignores the fact that not all 55 jurisdictions had inclusionary requirements for the entire 1980-2006 period, as illustrated in Table 4.2 on page 36 of the study:

Table 4.2 Timing of IZ Adoption, Bay Area

<u>Year IZ Adopted</u>	<u>Jurisdictions</u>	<u>Percent</u>
Pre-1980	5	9%
1980-89	15	27%
1990-99	27	49%
2000-04	<u>8</u>	<u>15%</u>
Total	55	100%

The study does not include a level of detailed data necessary to determine affordable housing production vs. total housing production for each jurisdiction based on the year that its inclusionary program was adopted. Thus, while it is fairly obvious that the 2.3% figure in the quote from the Furman study is misleading, it is not possible determine what the correct answer should be.

Finally, it appears that the affordable housing production number cited excludes affordable units produced with subsidies provided by localities. If that is the case, the study under-reports the overall impacts of inclusionary housing programs because it ignores those affordable units for which the source of local government subsidy was inclusionary in-lieu fees.

The publication, *Affordable By Choice: Trends in California's Inclusionary Housing Programs*, released on August 14, 2007 by the Nonprofit Housing Association of Northern California in cooperation with California Coalition for Rural Housing, San Diego Housing Federation, and Sacramento Housing Alliance, indicated that 91 inclusionary housing programs in California reported the development of 21,942 units between 1999-2006 (note that this study has similar concerns as the Furman study in that some of the jurisdictions only recently created their ordinances, therefore data does not cover the entire seven years of the report).

### 3. Communications Hill

Communications Hill is one of ten planned development areas in the City. The others are: Evergreen, Berryessa, Silver Creek, Jackson Taylor, Midtown, Tamien Station, Martha Gardens, Alviso, and Rincon South. While several of these areas have nearly reached their residential capacity as defined by the plans, others have active developments underway. The remaining development capacity for these areas is estimated at 20,000 residential units, which is a significant amount of the City's anticipated future development. Most of these areas are quite large and include a Redevelopment Project Area within their boundaries that already have inclusionary requirements. Exempting all of these areas would make the inclusionary ordinance very limited, and would not meet the guiding principle of consistency and fairness, as large swaths of the City would be exempted if they met the timeline goals.

Communications Hill is a 500-acre specific planning area that has the capacity for 5,000 units, some of which have already been completed. There is currently a PD pre-rezoning application that has been submitted for 2,389 residential units. Unlike other planning areas, there is not a Redevelopment Project Area that overlays the Communications Hill planning area.

The staff recommendation allows for any planning area to be grandfathered in as long as it does not contain an RdA Project Area that already requires inclusionary units, and that development continues to move forward on a timely basis. Communications Hill and its 2,389 units would be grandfathered in under this definition. This responds to concerns about how the inclusionary policy would impact large phased projects like Communications Hill, but does result in the loss of a potential 358 units (using the 15% requirement) and 478 units (using the 20% requirement).