



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: September 5, 2017

Approved

D. DSYL

Date

9/8/17

**SUBJECT: POTENTIAL MODIFICATIONS TO THE AFFORDABLE HOUSING
IMPACT FEE AND INCLUSIONARY HOUSING PROGRAMS**

RECOMMENDATION

1. Accept the status report regarding potential changes to the Affordable Housing Impact Fee and Inclusionary Housing Programs.
2. Adopt a resolution that amends Resolution No. 77218 as previously amended by resolution No. 708010 (collectively, "Housing Impact Fee Resolution") to:
 - a. Revise the definition of "dwelling unit" to clarify the distinguishing characteristics of a unit subject to the Affordable Housing Impact Fee; and
 - b. Allow developers of qualifying projects with Affordable Rental Apartments to apply for a different method of calculating their required Affordable Housing Impact Fee.
3. Direct the City Attorney and Housing Department to return with a new ordinance imposing an inclusionary housing obligation on for-sale projects with three (3) to 19 homes.

OUTCOME

Approval of the recommended actions will clarify distinguishing characteristics of dwelling units subject to the Affordable Housing Impact Fee (AHIF), encourage the development of on-site affordable units, and apply the inclusionary housing requirements to smaller projects so as to minimize procedural discrepancies between the Inclusionary Housing and AHIF Programs. The recommended actions will simplify processes, improve efficiency, and provide certainty for developers of projects, regardless of whether they are rental or for-sale.

BACKGROUND

On November 18, 2014, the City Council adopted the Housing Impact Fee Resolution, establishing the AHIF Program. On November 10, 2015, and December 6, 2016, staff reported back to City Council regarding issues that were raised when the AHIF Resolution was originally adopted.

On December 6, 2016, the Council adopted Resolution No.78010 amending the Housing Impact Fee Resolution to revise the provisions exempting for-sale projects from the AHIF to make the standard consistent with the staff report, the adopted AHIF regulations, and the adopted Inclusionary Housing Ordinance guidelines. During the December 6, 2016, City Council meeting, the City Council requested that staff consider an amendment to the AHIF Resolution to clarify the “dwelling unit” definition and an alternate method of fee assessment for projects sponsored by a public agency. In addition, the City Council further directed the City Attorney to return with an analysis regarding reducing the project threshold size to which the Inclusionary Housing Program applies. Finally, the City Council directed staff to return with an analysis, in coordination with the Office of Economic Development, of the AHIF’s potential impacts on mixed-use projects. Staff expects to report back on this item this winter.

ANALYSIS

The Housing Department has completed the following tasks per the direction provided by City Council on December 6, 2016.

Definition of a Dwelling Unit in the AHIF Program

Following City Council directive, the Housing Department researched the assisted-care industry and engaged with developers and operators of assisted living/memory care facilities. The individuals contacted expressed concern regarding the definition of a “dwelling unit” in the AHIF Resolution, particularly the interpretation of the term “housekeeping facilities” as being evidenced by a second sink in the living area. This interpretation is based on the fact that if a unit with its own bathroom has a second sink in the living area and a 120V outlet, a small “dorm” refrigerator and a microwave oven or hotplate could be added at any time.

In many assisted living/memory care facilities, the senior apartment units and their memory care units include a second sink in the living space, in addition to the bathroom sink. Most developers of assisted living/memory care facilities do not include cooking or refrigeration amenities, or space for those amenities, in memory care units due to safety concerns for their residents.

The Housing Department recommends that the definition of a “dwelling unit” in the AHIF Resolution be clarified so that it only be imposed on units that include the following features: (a) a bathroom, (b) a separate sink, and (c) the capability (i.e., two distinct electrical outlets and space for each) for cooking and refrigeration. Please see **Attachment A** for an example of how the proposed modification to the definition of a “dwelling unit” would alter the AHIF calculation.

Alternate Method for AHIF Fee Reduction for certain Qualifying Projects

Per Council direction, the Housing Department considered proposed amendments to the AHIF Program that would allow developers of certain types of projects, such as those constructed on public property, an alternative method of reducing their required AHIF by providing affordable apartments onsite, under certain conditions. Currently, a developer who is already required to create restricted affordable apartments as the result of government action or funding will not pay the AHIF for those restricted apartments if they are affordable to low income families.

Restricted affordable units may also be created where a public agency records a covenant requiring the inclusion of units in the project that are affordable to low, very low and extremely low-income residents on land that the agency is leasing for residential development. In this limited category, the existing obligations of a public agency to provide affordable units on-site may result in more affordable units being developed than the current AHIF Program requirement.

The Housing Department recommends establishing an alternative methodology that allows those qualifying projects to apply for an alternative calculation of the AHIF if they can provide evidence that the affordable apartments proposed within their project meet certain affordability levels, as identified in the October 2014 Nexus Analysis. Staff recommends the following provisions for qualifying projects with onsite affordable rental apartments:

- The amount of the reduction will be based on comparing (a) the affordable rental apartments, and the respective level of affordability provided, to (b) the projected impact of all of the rental apartments in the residential development.
- The affordability covenant recorded by that agency must have a term of at least 55 years from occupancy and be enforceable by the City under the rider described below.
- The City will be entitled to record a rider to that affordability restriction on the site to be sold or leased effective until 55 years after certificate of occupancy.
- Affordable units in one income category cannot be credited to other income categories not addressed in the approved on-site affordability mix of affordable units.
- No affordable units on one site will be credited to another site, and affordable units must be constructed at the same time as, and with similar quality to, other units.
- This option would only apply if the City has provided no financial assistance to the developer or public agency in connection with the otherwise qualified project. The City could invest in the project if a greater affordability is achieved (either in depth or number of units) than over what would have otherwise been required.

An example of how the alternate method described above would alter the AHIF calculation for qualifying projects is provided as **Attachment B**.

Modification to the Threshold Size of the Inclusionary Housing Program

Currently, the Inclusionary Housing Program applies to for-sale projects of 20 or more homes. The AHIF Program applies to rental projects of three (3) or more apartments. On December 6, 2016, the Housing Department recommended that rental projects of three (3) to 19 apartments be exempted from the AHIF. At that time, City Council did not approve staff's recommendation and directed staff to return with an analysis regarding the potential for applying the Inclusionary Housing Program to for-sale projects of three (3) to 19 units.

The Housing Department has completed its analysis. The Department recommends the development of a separate inclusionary housing ordinance for projects of three (3) to 19 homes, which should include a 15% onsite obligation, or an In-Lieu Fee option. The fee would be assessed at the same rate as the AHIF. Developers of projects of three (3) homes will be required to pay the In-Lieu Fee because these developments, with a 15% obligation, will not result in an obligation of building an additional onsite unit. Therefore, projects of four (4) to 19 homes will have the option of building onsite or paying the In-Lieu Fee.

The methodology for assessing the Small Project In-Lieu Fee is intended to align with the AHIF Program to maximize administrative efficiencies. The Small Project In-Lieu Fee under discussion would:

- Apply to for-sale projects of three (3) to 19 homes at a per square foot rate;
- Be assessed at a rate consistent with the AHIF (\$17.41 per square foot in FY 2017-18; increased by 2.4% annually); and
- Apply to any for-sale project of three (3) to 19 homes for which all building permits have not been pulled by December 31, 2017.

This proposed approach will minimize the procedural discrepancies between the Inclusionary Housing and AHIF Programs, simplify processes, improve efficiency, and provide certainty for developers of projects of three (3) to 19 units, regardless of whether they are rental or for-sale. If this recommended action is approved, staff will work with the City Attorney's Office and return to City Council in the late fall or early winter with a draft ordinance for consideration.

EVALUATION AND FOLLOW-UP

Consistent with the requirements of the Mitigation Fee Act, the City will provide an annual report on actual AHIF revenues, future revenue projections, and expenditures of those revenues once revenues have been received. In this annual report, the Housing Department will also report on affordable housing units provided as on-site mitigation to partially or fully satisfy the

AHIF obligation. As mentioned, the Housing Department will return with an analysis, in coordination with the Office of Economic Development, on the AHIF's potential impacts on mixed-use projects this winter.

POLICY ALTERNATIVES

Alternative #1: *Maintain the current definition of a “dwelling unit” subject to the AHIF for all unit types including those within Assisted Living communities.*

Pros: The Housing Department and the City Attorney's Office would not modify the programs, thereby saving staff time.

Cons: Units designed to assist individuals with memory/health issues would be subject to the AHIF.

Reasons for not Recommending: The modification to the Dwelling Unit definition would establish a method to assess whether the AHIF applies to units that resemble a commercial use such as a hospital or convalescent home.

Alternative #2: *Do not establish an Inclusionary Housing requirement for for-sale developments of three (3) to 19 homes.*

Pros: Expanding the Inclusionary Housing requirement would increase the revenue collected for affordable housing programs.

Cons: The City would forego an opportunity to increase the supply of affordable housing or collect fees that would fund the development of more affordable units.

Reasons for not Recommending: Increasing the supply of affordable housing in San José is a City priority. Additionally, the different thresholds between the Inclusionary Housing Ordinance and the AHIF increase the complexity and cost of managing the Program.

PUBLIC OUTREACH

On July 13, 2017, the Housing Department posted its draft recommendations on its website. The Housing Department hosted a meeting of residential developers and stakeholders on July 20, 2017, to discuss its proposed recommendations for amending the AHIF regarding the definition of a “dwelling unit,” on-site mitigation of the AHIF obligation, and the modification of the threshold size under the Inclusionary Housing Programs. Notices and reminders of the public meeting were sent to more than 400 individuals/organizations and posted on the Housing Department website.

In total, 27 individuals attended the outreach meeting, including developers, community organizations, and San José City Council staff. At the meeting, staff received the following feedback:

- The term “capability” in the revised definition of “dwelling unit” (Item 1) should be further clarified, with specific examples; and
- The City should consider extending the AHIF on-site mitigation option to more than government entities (Item 2).

The meeting concluded with an invitation to submit additional points of feedback via email to Housing staff. Subsequently, staff clarified the definition of “dwelling unit” by illustrating the description of “capability for cooking and refrigeration” to include an example (i.e., two distinct electrical outlets and space for each).

COORDINATION

This item has been coordinated with the City Attorney’s Office and the City Manager’s Budget Office.

COMMISSION RECOMMENDATION/INPUT

The Housing Department’s recommendations were presented to HCDC on August 10, 2017. HCDC accepted staff’s report and unanimously supported these potential changes to the AHIF and Inclusionary Housing Programs.

COST IMPLICATIONS

Should City Council approve the Department’s recommendations, the modification to the AHIF’s “Dwelling Unit” definition may result in a decrease of AHIF revenue by an estimated \$200,000, annually. However, should City Council adopted the Housing Department’s recommendation to return with an ordinance imposing an inclusionary housing obligation on for-sale projects with three (3) to 19 homes, annual fee revenue could be increased by an estimated \$400,000 to \$500,000.

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CEQA

Not a Project, File No. PP10-067 – Section 15378(b)(4) of the Guidelines for Implementation of the California Environmental Quality Act excludes the following from the definition of projects subject to environmental review requirements: “The creation of a government funding mechanism or other government fiscal activities which do not involve any commitment to a specific project which may result in a potentially significant physical impact on the environment.”

/s/

JACKY MORALES-FERRAND

Director, Housing Department

For questions, please contact Patrick Heisinger, Acting Division Manager, at (408) 975-2647.

Attachment A – Example AHIF Calculation for Modified Definition of “Dwelling Unit”

Attachment B – Example AHIF Reduction for On-Site Mitigation

ATTACHMENT A

Example AHIF Calculation for Modified Definition of “Dwelling Unit”

Project Unit Mix / AHIF Calculation - Current		
Unit Type/Plan	# of Units	Gross Residential Sq. Footage
Studio	15	6,275
1-bed	33	22,670
2-bed	15	15,961
Memory Care Studio	25	10,000
Memory Care - Shared	12	5,200
Totals	100	60,106
Gross Square Ft	Current AHIF	Total Fee
60,106	\$17.41	\$1,046,445

Project Unit Mix / AHIF Calculation – Proposed		
Unit Type/Plan	# of Units	Gross Residential Sq. Footage
Studio	15	6,275
1-bed	33	22,670
2-bed	15	15,961
Memory Care Studio	NA	NA
Memory Care - Shared	NA	NA
Totals	63	44,906
Gross Square Ft	Current AHIF	Total Fee
44,906	\$17.41	\$781,813

If the modified definition of a “dwelling unit” is approved, only units that meet the proposed definition would be assessed the AHIF. In the example above, the AHIF would only apply to 75% of the total residential square footage.

ATTACHMENT B

Example AHIF Reduction for On-Site Mitigation

Project Assumptions	
Total # Units in Project	300
Total # Market Rate Units	240
Total # Affordable Units 30% AMI	20
Total # Affordable Units 50% AMI	20
Total # Affordable Units 60% AMI	20
Average Unit Size (Sq. Ft.)	900
AHIF Fee (Per Sq. Ft.)	\$17.41

AHIF Calculation – Current			
Total # Market Rate	Average Unit Size (Sq. Ft.)	AHIF (Per Sq. Ft.)	Project AHIF
240	900	\$17.41	\$3,760,560

AHIF Calculation – Reduction for On-Site Mitigation – Proposed					
AMI Levels Identified in Nexus Study	Demand for Affordable Units		Affordable Units Provided within Project	Remaining Obligation (Demand – Units Provided)	Remaining AHIF Obligation for Project
	% of Units to Meet Demand	# of Units Within Project			
30%	2.5%	7.5	20	0	\$0
50%	5.1%	15.3	20	0	\$0
80%	5.3%	15.9	20	0	\$0
120%	3.3%	9.9	0	9.9	\$766,040
Total Project AHIF Fee					\$766,040

If the recommended option of on-site mitigation for a project’s AHIF obligation is approved, the Fee would be reduced to the amount not mitigated by providing affordable units on-site. In the example above, the project’s plan for providing 60 affordable units would satisfy three of the four income levels that would otherwise be required. Therefore, the project’s AHIF would decrease from \$3,760,560 to \$766,040.