



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: October 10, 2017

Approved

D. D. S. L.

Date

10/12/17

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

RECOMMENDATION

1. Accept the staff report regarding potential changes to the Affordable Housing Impact Fee and Inclusionary Housing Programs and the impact of AB 1505 on those programs.
2. Adopt a resolution that amends Resolution No. 77218 as previously amended by resolution No. 78010 (collectively, "Housing Impact Fee Resolution") to revise the definition of "dwelling unit" to clarify the distinguishing characteristics of a unit subject to the Affordable Housing Impact Fee.
3. Direct the City Attorney and Housing Department to return with a new ordinance that imposes an inclusionary housing obligation on for-sale and rental projects with three (3) to nineteen (19) homes.

OUTCOME

Approval of the recommended actions will clarify distinguishing characteristics of dwelling units subject to the Affordable Housing Impact Fee, and extend the inclusionary housing requirements to smaller projects: both for-sale and rental. The recommended actions will simplify processes, improve efficiency, and reduce uncertainty for developers, regardless of whether their projects are rental or for-sale.

BACKGROUND

The City currently has two affordable housing programs that apply to new planning applications for residential developments. Going forward, these programs will be affected by the State's adoption of AB 1505 "Palmer fix" legislation which authorizes the control of rents in Inclusionary Units effective January 1, 2018. This legislation is discussed in greater detail below.

Inclusionary Housing Ordinance

The Inclusionary Housing Ordinance was approved on January 12, 2010. The Inclusionary Housing Ordinance generally requires that, in market-rate developments of 20 or more units, 15% of the units be made affordable to income eligible buyers/renters. The Inclusionary Housing Ordinance provides alternative ways that the developer can meet this requirement, including payment of an in-lieu fee and construction of affordable units off-site.

Although the Inclusionary Housing Ordinance contains provisions for inclusionary rental housing, those provisions will take effect only if the appellate court decision *Palmer v. City of Los Angeles* is overturned. Regarding Rental Residential Development, the Inclusionary Housing Ordinance (Section 5.08.400) states:

This Subsection 5.08.400.A.1.b shall be operative at such time as current appellate case law in Palmer/Sixth Street Properties, L.P. v. City of Los Angeles (2nd Dist. 2009) 175 Cal.App.4th 1396, is overturned, disapproved, or depublished by a court of competent jurisdiction or modified by the state legislature to authorize control of rents in Inclusionary Units.

Affordable Housing Impact Fee (AHIF)

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, City Council adopted Resolution No.78010, which amended the Housing Impact Fee Resolution. The amendment clarified that for-sale projects are not subject to the AHIF, thereby adopting a standard that was 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 the following:

- Staff consider an amendment to the AHIF Resolution to clarify the definition of a "dwelling unit;"
- City Attorney return with an analysis regarding reducing the project threshold size to which the Inclusionary Housing Program applies; and

- Staff return with an analysis, in coordination with the Office of Economic Development, of the AHIF's potential impacts on mixed-use projects and an alternate method of fee assessment for projects sponsored by a public agency.

California Assembly Bill (AB) 1505

Assembly Bill (AB) 1505 was introduced on February 17, 2017. The legislation:

- (1) explicitly authorizes cities and counties to adopt ordinances that require, as a condition of the development of residential rental units, that the development include up to 15% of residential rental units to affordable- to moderate-income, lower-income, very low-income, or extremely low-income households;
- (2) clarifies the Legislature's intent to supersede the court decision in *Palmer v. City of Los Angeles*, thereby making inclusionary housing requirements apply to rental developments; and
- (3) requires any such ordinance to provide alternative means of compliance, such as in-lieu fees, land dedication, off-site construction, or acquisition/rehab of existing units.

On August 15, 2017, the City Council adopted a position of support for Assembly Bill (AB) 1505 which would allow the City to fully implement its Inclusionary Housing Ordinance. On September 8, 2017, the California State Assembly approved AB 1505, thus clarifying the Legislature's intent to supersede the court decision in *Palmer v. City of Los Angeles* and allowing inclusionary housing requirements to apply to rental developments.

On September 29, 2017, the Governor signed AB 1505, which will go into effect on January 1, 2018. As a result, the Inclusionary Housing Ordinance will automatically extend new first approvals for residential rental projects for which applications for first approval are submitted after January 1, 2018.

ANALYSIS

The Housing Department has completed the following tasks per the direction provided by City Council on December 6, 2016. The Housing Department is recommending modifying the definition of a "dwelling unit" because this change may impact current projects that are seeking planning approvals before January 1, 2018, and therefore would be subject to the AHIF Program.

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, as well as 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 those facilities, due to safety concerns for their residents.

The Housing Department recommends that the definition of a “dwelling unit” in the AHIF Resolution be described as 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.

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. 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 and recommends the development of a separate inclusionary housing ordinance for projects of three (3) to 19 homes. The recommended ordinance would:

- Include all compliance options available in the Inclusionary Housing Ordinance. For example, 15% build on-site, 20% build off-site, payment of an In-Lieu Fee, dedication of land, etc.¹
- 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.
- Also be applied to rental projects of three (3) to 19 units, if AB 1505 is enacted.

If this recommended action is approved, staff will work with the City Attorney’s Office and return to City Council with a draft ordinance for consideration.

¹ For situations in which a project’s obligation does not round up to one unit, the obligation still applies and may be satisfied by any of the compliance options including, but not limited to, the fee, which would be applied on a pro rata basis.

Remaining City Council Follow-up Items

With adoption of AB 1505, all projects that submit applications for First Approval to Planning, Building, and Code Enforcement (PBCE) after January 1, 2018, will be subject to the Inclusionary Housing Ordinance. Therefore, the Inclusionary Housing Ordinance will govern all new projects, and the AHIF will no longer apply to new rental development, but will continue to apply to all developments subject to the AHIF based on prior compliance plans and affordable housing agreements.

The Inclusionary Housing Ordinance will now pertain to both new rental and for-sale developments. As such, there is no longer a need to consider other previously contemplated amendments to the AHIF for new projects:

- 1) Addition of an alternate method of fee assessment to the AHIF for projects sponsored by a public agency is not necessary because the Inclusionary Housing Ordinance already provides developers with several options for satisfying their affordable housing obligation, including construction of affordable units on- or off-site; and
- 2) Studying the potential impacts of the AHIF on mixed-use projects is no longer applicable because the AHIF has been superseded by the Inclusionary Housing Ordinance.

However, the City's approved Schedule of Fees and Charges currently does not include an Inclusionary Housing Ordinance rental in lieu fee. Therefore, the Housing Department will bring a resolution to City Council to establish an In Lieu Fee for rental projects in accordance with the Inclusionary Housing Ordinance.

Inclusionary Housing Guidelines and Future Community Outreach

The Housing Department will amend the Inclusionary Housing Program Guidelines for adoption by the City Manager, to account for the fact that rental developments will be subject to the City's Inclusionary Housing Ordinance so as to have those Guidelines amended before the effective date of January 1, 2018.

In October 2017, the Housing Department will initiate extensive outreach to notify developers and other stakeholders of impacts related to the adoption of AB 1505. The Housing Department will host informational community meetings in October and November, 2017, and will attend PBCE's October Developers and Construction Roundtable meeting. Additional information and outreach activities will be held in December 2017, if needed. Notification of all outreach activities will be posted to the Housing Department's webpage (sjhousing.org) and sent to more than 300 recipients who have expressed interest in receiving email updates regarding the City of San José's affordable housing programs.

EVALUATION AND FOLLOW-UP

If City Council approves staff recommendations as outlined in this memorandum, the Housing Department will return to City Council with the following:

- 1) A draft inclusionary housing ordinance regarding projects of three (3) to 19 homes for consideration; and
- 2) A resolution with a recommendation to establish an In Lieu Fee for rental projects in accordance with the Inclusionary Housing Ordinance.

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 dormitory 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: The Housing Department and the City Attorney’s Office would not need to prepare a new ordinance and modify the programs, thereby saving staff time.

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.

Alternative #3: *Do not establish an Inclusionary Housing requirement for rental developments of three (3) to 19 units.*

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

Cons: The City Council has already expressed a commitment to applying affordable housing obligations to rental projects of three (3) or more units. If this is not added to small projects Inclusionary (or the AHIF retained for small projects), then the contribution from these projects would be lost.

Reasons for not Recommending: Increasing the supply of affordable housing in San José is a City priority.

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” should be further clarified, with specific examples; and
- The City should consider extending the AHIF on-site mitigation option to more than government entities. As noted in this memorandum, the Housing Department is deferring responding to “on-site mitigation” comments pending approval of AB 1505.

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 \$100,000 to \$200,000, annually. However, should City Council adopt the Housing Department's recommendation to return with an ordinance imposing an inclusionary housing obligation on projects with three (3) to 19 homes, annual fee revenue could be increased by an estimated \$500,000 to \$750,000.

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no 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 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 project’s total residential square footage.