



COUNCIL AGENDA: 09/10/19
FILE: 19-762
ITEM: 4.3

Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Rosalynn Hughey
Jim Shannon

SUBJECT: SEE BELOW

DATE: August 29, 2019

Approved

D. D. S. L.

Date

8/30/19

SUBJECT: AWARD \$5 MILLION TO THE HOUSING TRUST SILICON VALLEY TO IMPLEMENT AN ACCESSORY DWELLING UNIT FORGIVABLE LOAN PROGRAM AND WAIVE CERTAIN CITY FEES TO FACILITATE FURTHER ADU DEVELOPMENT AND APPROPRIATION ACTIONS

RECOMMENDATION

- (a) Accept the staff report and adopt a resolution:
- (1) Authorizing the Director of Housing to negotiate and execute an agreement with the Housing Trust Silicon Valley to provide funding for forgivable loans to homeowners in the City of San José who build a legal accessory dwelling unit and agree to house an income eligible household for a period of five years; and,
 - (2) Approving the award of up to \$1,250,000 in funding to the Housing Trust of Silicon Valley through June 30, 2020 with the option to extend the term of the agreement through June 30, 2024 and increase the agreement amount not to exceed \$5,000,000, subject to annual appropriation of funds.
- (b) Adopt the following 2019-2020 Appropriation Ordinance Amendments in the General Fund:
- (1) Decrease the Homeless Rapid Rehousing City-Wide appropriation to the Housing Department in the amount of \$1,250,000; and,
 - (2) Establish an ADU Forgivable Loan Program City-Wide appropriation to the Housing Department in the amount of \$1,250,000.

- (c) Adopt the following 2019-2020 Appropriation Ordinance Amendments in the Multi-Source Housing Fund:
- (1) Decrease the City Housing Authority Reserve appropriation by \$1,250,000;
 - (2) Increase the Bridge Housing appropriation to the Housing Department in the amount of \$670,000; and,
 - (3) Increase the Homeless Rapid Rehousing appropriation to the Housing Department in the amount of \$580,000.
- (d) Direct the Administration to work with the City Attorney's Office to return to Council for consideration of an ordinance or resolution suspending or waiving the collection of the annual business tax and park impact in-lieu fees for certain qualifying accessory dwelling units and the landlords thereof as further described in this memorandum during the five-year compliance period.

OUTCOME

The City Council's approval of the funding award will allow the Housing Trust Silicon Valley (HTSV) to provide 200 forgivable loans of up to \$20,000 to homeowners in the City of San José to assist in building a legal accessory dwelling unit (ADU) with the agreement to house an income eligible household for a period of five years.

EXECUTIVE SUMMARY

The "Yes, In My Backyard" affordable housing program proposed by Mayor Liccardo and Councilmembers Carrasco, Arenas, and Foley directed the City Manager to work with key partners to waive fees and provide forgivable loans for homeowners in San José who build an ADU or convert a garage into a housing unit. In exchange, the owners will agree to restrict rents to a level of affordability that enables the tenancy of a low- to moderate-income household for at least five years. The Housing Department will negotiate and execute an agreement with HTSV to provide \$5 million in funding for forgivable loans to homeowners. Each forgivable loan provided to a qualified homeowner by HTSV will be up to \$20,000 to cover planning, permit, and other predevelopment soft costs for a legal ADU. The loan will mature six years from loan closing term, but will be forgivable after five years of occupancy by an income eligible tenant. It is expected that HTSV will approve and close approximately 200 loans for ADU's over five years.

BACKGROUND

In September 2017, Mayor Liccardo released the "Responding to the Housing Crisis" memorandum that identified a variety of programs and strategies that the City should undertake to address the housing crisis. One of those strategies included facilitating the development of accessory dwelling units by streamlining the ADU and garage conversion process and

eliminating unnecessary regulations. While the efforts saw some modest success, the challenge remained in getting ADU's built and inhabited.

On May 22, 2019, the Rules and Open Government Committee for Council consideration approved a memorandum written by Mayor Liccardo along with Councilmembers Carrasco, Arenas, and Foley, that proposed several initiatives to spur the production of ADUs. The memorandum directed the City Manager to develop a "Yes, In My Backyard" affordable housing program and to waive certain City impact fees and provide forgivable loans to cover a portion of the cost of building ADU's. Homeowners who obtain the forgivable loans agree to build an ADU or convert a garage into a housing unit and to restrict rents to a level of affordability that enables the tenancy of a low- to moderate-income household for at least five years. The recommendation also directed the Housing Department to partner with HTSV to administer the forgivable loan program with an initial allocation of \$5.0 million, with the goal of getting ADU's built and inhabited within the City of San José.

On June 25, the City Council directed the Housing Department to move forward with the development of the loan program with HTSV and to coordinate with the Parks, Recreation, and Neighborhood Services Department (PRNS) regarding the potential park impact in-lieu fee waiver for ADUs. This memorandum provides an overview of the loan program and an update on efforts to streamline the ADU approval process.

ANALYSIS

Forgivable Loan Program

The Housing Department will negotiate and execute an agreement with HTSV to provide \$5.0 million in funding from the General Fund for forgivable loans to homeowners in the City of San José who build a new legal ADU and agree to house an income eligible household for a period of five years.

Each forgivable loan provided to a qualified homeowner by HTSV will be up to \$20,000 to cover planning, permit, and other predevelopment soft costs for a legal ADU in San José. The loan will be evidenced by a promissory note and a recorded deed of trust. The loan will mature six years from loan closing term, but forgivable after five years of occupancy by an income eligible tenant. Homeowners must market the ADU and provide the HTSV with language for the listing and where it will be listed. Tenants household income must be no more than 120% of Area Median Income (AMI) or below at the time of initial occupancy and for any subsequent new tenant. Rents will be set at 30% to 90% of the AMI based on the size of the ADU per the City of San José Income and Rent Limit Table (Attachment A). This will allow a greater range of individuals who can afford to rent the ADU. Owners will be required to provide a one-year written lease and annual rent increases will be capped at five percent per year or the annual increase in the area median income, whichever is less. Exceptions will be made in the case where a tenant holds a Housing Choice Voucher. The loan will be considered in default if the owner fails to rent the ADU or lists the ADU in any short-term rental services such as AirBnB.

Additionally, HTSV will be responsible for administering the program which includes creating all loan documents, income certifying the tenant, monitoring, and verifying annual rents. Quarterly and annual reports will be submitted to the City.

Program funds provided in the first year will be used to develop the ADU Forgivable Loan Program and to make loan approvals. The City will advance approximately \$95,000 to HTSV once the contract has been fully executed to fund the set-up costs, legal documents, and regulatory compliance review. No additional funds will be released until the HTSV provides appropriate documentation to support the advance. The remainder of the budget will be based on a reimbursement basis of monthly expenditures. Recommended in this memorandum is an action to appropriate \$1.25 million in 2019-2020 for this program with three subsequent annual contributions of \$1.25 million, subject to program performance, availability of funds, and annual appropriation of funds for a total program contribution of \$5.0 million.

The first year will be focused on marketing the program and providing six half day workshops and six one-hour information sessions to educate potential participants on the program. After the first year, HTSV expects to have at least 30 loans approved. Years two through five will see the same amount of workshops and information sessions for homeowners interested in the ADU Forgivable Loan program, as well as approving and closing up to 200 loans to homeowners. HTSV will be expected to report on its progress quarterly where further analysis will be done to determine ADU trends such as types, costs, and preferences.

Funding Shift

Forgivable loans cannot be issued to non-income eligible homeowners under the Housing Department's restricted special funding sources. However, such loans may be granted by the General Fund. The Housing Department has \$4.0 million in ongoing funding in the General Fund for homeless rapid rehousing activities, and \$15.2 million remaining in reserve from the \$36.3 million Housing Authority Litigation Award Settlement in the Multi-Source Housing Fund. The Housing Department will shift a total of up to \$5.0 million, over four years beginning in 2019-2020, in eligible homeless rapid rehousing expenditures into the Housing Authority Litigation Award Settlement fund, thereby allowing the General Fund to pay for the ADU Forgivable Loan Program expenditures without a decrease in service levels. The largest expenditure to be shifted out of the General Fund Homeless Rapid Rehousing appropriation are operating costs for two Bridge Housing sites as approved by City Council on December 18, 2018.

Impact Fees

By current ordinance all new residential development within the City is subject to fulfill a parkland dedication obligation under Chapter 19.38 (PDO – Parkland Dedication Ordinance) and/or SJMC Chapter 14.25 (PIO – Park Impact Ordinance). The PDO/PIO (Park Impact In-Lieu Fees) were adopted in alignment with State law (the Quimby Act) to allow the City a method to reduce the impact new residential populations have on existing recreational amenities and to provide the City with the means to acquire new land and provide new or improved recreational

amenities. Compliance with the PDO/PIO also provides projects the means to determine that new residential development is a less than significant impact per CEQA statutes. Park Impact In-Lieu fees for ADUs are currently set at 50% of the rate for the Single Room Occupancy (SRO) housing type (Resolution #7874 adopted 12/19/2019). Since the adoption of the permanent ADU program in 2008, the City has seen an increase in the number of park impact fee collections for ADU production, as exemplified in the five-year span in Table 1.

Table 1 - ADU Park Impact In-Lieu Fee Collection 2014 – 2019

Fiscal Year	Amount	# of Collections
2018-2019	\$ 1,150,250	352
2017-2018	\$ 404,650	132
2016-2017	\$ 141,600	43
2015-2016	\$ 68,450	25
2014-2015	\$ 26,300	13
Total	\$ 1,791,250	565

The City currently has \$341 million in parks related unfunded deferred maintenance and infrastructure costs. ADU fees have supported projects such as: Mayfair Community Center Improvements, Del Monte Park Phase I & Phase II, Coyote Creek Trail completion (Story Road to Tully Road), and Camden Community Center improvements. These fees also support portions of staff salaries and minor infrastructure improvements such as benches, picnic tables, barbeque pits, and water fountain replacements.

Park impact in-lieu fees range between \$1,700 per unit in MLS district #7A (Alviso - lowest) to \$8,900 in MLS District #7B (North San Jose- highest). The average cost of ADU park impact in-lieu fees across all MLS districts has been \$3,297 over the last five years. Based on this average, the estimated lost impact fees for 200 ADUs would be \$659,400 (low of \$340,000 - high of \$1,780,000). These fees would not be available to support improving parks, trails, and community centers. However, as park in-lieu fees must be expended within a close proximity to where they were collected, the broad geographical distribution of the ADUs under the loan program would provide marginal benefit to the overall parks capital improvement program. If the waiver of park impact fees is approved as recommended, changes to existing municipal codes and resolutions may be required.

Business Tax

Chapter 4.76 of the San José Municipal Code requires that every person in the City engaged in the business of renting or leasing any residential real estate shall pay a business tax based on the number of rental units held for rental at the following rates:

Residential Landlords: Rental Units	Effective July 1, 2019
Base Tax: 1-2 units	\$200.85
Incremental Tax: 3-35	\$10.60
Incremental Tax: 36-100	\$15.90
Incremental Tax: 101-500	\$21.20
Incremental Tax: 501+	\$26.50
Cap	\$159,135

Staff is recommending that residential landlords participating in the HTSV program will be eligible for an exemption, thereby waiving business tax for the qualified ADU's during the five-year compliance period. Other rental properties not covered by the HTSV program are subject to the business tax. Assuming 200 ADUs are created under the loan program, the waived tax revenue over a five-year period would be approximately \$200,000. After the five-year compliance period, the business tax will be payable, if the landlord continues to rent the ADU. Staff will need to return with a modification of the Ordinance to allow for the time limited exemption.

ADU Process Streamlining

The City has seen a dramatic increase in the number of ADU applications. Comparing the first half of 2016 to 2019, the number of ADU applications have increased nearly tenfold. To address this surge in demand, staff have begun analyzing our existing processes to identify enhancements. In addition to this analysis, Council has given direction for enhancements which are at various stages of implementation.

Staff's analysis identified three categories of enhancement opportunities that will both improve the efficiency of existing processes and expand the scale of permitting capabilities.

1. Clarify and streamline requirements for customers to prevent downstream issues in the permitting process.
2. Develop categories of ADUs based on their level of complexity with corresponding processes to provide improved customized service based on the needs of different customer service types.

3. Dedicate specialized staffing resources that can improve efficiency in the ADU permitting process and reduce ADU pipeline's burden on the overall permitting processes.

The subsections below identify enhancements to operations that strive towards these opportunities. A status update will be provided along with next steps or hurdles to implementation for those initiatives that have not yet been implemented.

Current Enhancements

The enhancement initiative with the greatest immediate benefit was improving the communication of process and requirements for ADU customers. Providing clear, concise, and complete information to customers early in the process prevents issues from arising downstream which take up staff time, cause unnecessary review cycles, and cost customers time and money. Taking stock of existing public content, staff recognized that requirements were spread across several locations on the City's website and that some of those requirements may appear to be inconsistent with each other.

As a result, staff have consolidated all ADU information for all development service partner departments onto a single shared website (<http://www.sanjoseca.gov/adus>). On this webpage, customers can learn about the process, find all forms related to ADUs, and answer some of their most common questions for ADUs. Staff have also consolidated all the requirements of the various departments onto a single universal checklist.

While clarity in the City's requirements is a foundational improvement to the ADU permit process, staff have worked collaboratively to find opportunities to create flexibility in existing requirements. While improvements in the Planning ordinances have already made major impact to the number of ADU applications submitted, additional flexibility in the Fire requirements have been identified. The Fire Department expanded the distance that an ADU can be from the street (from 150 feet to 200 feet) and the distance from the nearest hydrant access (from 400 feet to 600 feet). This opportunity was a prime example of extending the scope of potential ADU customers while maintaining safety standards.

To improve the permitting process, staff kicked off a pilot program on August 6, 2019, called "ADU Tuesdays". This process enhancement focuses resources in the Permit Center one day of the week to provide specialized support to ADU customers with two new services:

- Dedicated Express Plan Check Appointments, and
- Priority application submittal

First, the dedicated Express Plan Check Appointments allows the customer to meet with an inter-department team of staff to get immediate feedback and potential approval for a building permit. Projects that meet certain criteria are eligible for the Express Plan Check Appointments.

The second service available on "ADU Tuesdays" is the new dedicated submission lane in the Permit Center available to any ADU customer. The dedicated intake staff member will conduct a

thorough review to provide immediate comments on mistakes in applications that will allow customers to fix their mistakes earlier and prevent wasteful, incomplete reviews by Plan Check staff.

To provide more accessible information to customers, staff is retrofitting the current public information kiosk to exclusively offer ADU informational materials. This information will be provided in three languages. The kiosk will be placed in the Permit Center in early fall 2019.

ADU Ally Program

A pilot program mirrored after the successful Small Business Ally program, a temporary ADU Ally position will help promote the ADU program to residents and help those customers throughout the process to make it as seamless as possible. The greatest opportunity for this position is the ability to prevent issues for both customers and the City staff. By resolving issues earlier in the process, customers can save time and prevent costly re-work that takes staff time from reviewing other ADU applications. Through the reallocation of existing resources, a temporary position will serve as the ADU Ally through June 2020. A member of the Building Division has been temporarily assigned to the ADU Ally role to facilitate the initiation of the program until the position is filled.

ADU Master Plan Program

Staff has also launched the ADU Master Plan program. This program creates an application process for designers and builders who offer building plans for detached ADUs, pre-fabricated homes, or wood-framed single-family homes that can be pre-approved by the City of San José. These vendors can then offer their ADU customers expedited plan review and permit issuances. Pre-approved “master plans” enable City staff to quickly review a proposed ADU application much quicker, by streamlining architectural and structural review. One pre-approved foundation design has been approved and several more plans are currently engaged in the process.

Upcoming Enhancements

Pursuant to Council direction, staff is developing an “ABC” checklist to support the triage of applications into different permit paths based the criteria an ADU meets and the variances the project requires. With the launch of “ADU Tuesdays”, staff are testing the “ABC” checklist by creating two triaged processes:

- Express Plan Check Appointments and
- Prioritized ADU application submission in the Permit Center

To help promote the ADU program to more prospective ADU customers, PBCE communication staff is developing an ADU Workbook. This easily accessible document will provide introductory materials for early stage customers to help get acquainted with the ADU program, benefits, and process. Staff expects to have the Workbook completed and posted to the ADU website in October 2019.

Further promotion for the ADU program is expected in the fall as staff works with HTSV to set up an ADU Showcase to promote the benefits of building an ADU. Staff is currently considering the most impactful design for the event, either building on the success of the May 30, 2019 Building Safety Event ADU presentation, which can be found at the following website (<https://www.youtube.com/watch?v=zujcjSljDhc&feature=youtu.be>), or providing a periodic workshop during “ADU Tuesdays” to provide customers coming into the Permit Center the resources and information they need for getting started with their ADU project.

EVALUATION AND FOLLOW-UP

Staff will provide an annual information memorandum on the ADU Forgivable Loan Program.

PUBLIC OUTREACH

This item will be posted to the City Council website for its September 10, 2019 meeting.

COMMISSION RECOMMENDATION/INPUT

This specific request was not taken to the Housing and Community Development Commission.

COORDINATION

Preparation of this report was coordinated with the Department of Parks, Recreation, and Neighborhood Services (PRNS), Department of Finance, the Office of Economic Development, and the City Attorney’s Office.

COST SUMMARY/IMPLICATIONS

The recommendations in this memorandum will develop an accessory dwelling unit forgivable loan program to be administered by the Housing Trust of Silicon Valley. The contract with the Housing Trust of Silicon Valley will go through June 30, 2020 in the amount of \$1.25 million, with the option to extend the term of the agreement through June 30, 2024 for a contract total of up to \$5.0 million. These funds are anticipated to provide 200 loans of \$20,000 each, for the total amount of \$3.9 million, and \$1.1 million in administrative costs for legal, marketing, loan issuance and monitoring, and loan fees. To fund the \$5.0 million loan program, it is recommended to reallocate funding of \$1.25 million from the \$4.0 million annual General Fund contribution for homeless rapid rehousing to establish the ADU Forgivable Loan Program. A portion of the rapid rehousing and the bridge housing activities previously funded by the General Fund will instead be funded Housing Litigation Award Funds within the Multi-Source Housing Fund. The funding shift will be included as part of the development of the annual Operating

Budget for subsequent years and is subject to the appropriation of funds. After the final year (2022-2023), the General Fund contribution for the Homeless Rapid Rehousing appropriation will be restored to \$4.0 million annually.

Park Impact In-Lieu fees are recommended to be waived for loan program participants; the estimated total of lost impact fees for 200 ADUs is approximately \$700,000 (low of \$340,000 - high of \$1,780,000). However, as noted above, the impact of the waived fees is anticipated to be minimal given that the fees that might have been collected are disbursed throughout the City. The waiving of business taxes over a five-year period would be roughly \$200,000.

The costs for the temporary position through June 2020 for the ADU Ally Program is anticipated to be absorbed through existing General Fund resources within PBCE and the Office of Economic Development. The Administration will monitor the departments' budget and, if necessary, will bring forward recommended budget adjustments for City Council approval as part of a future budget process. The continuation of the position and funding of the program beyond June 2020 will be evaluated as part of the annual budget process.

BUDGET REFERENCE

The table below identifies the fund and appropriations to fund the action recommended as part of this memo.

Fund #	Appn #	Appn. Name	Total Appn	Amt. for Action	2019-2020 Proposed Operating Budget Page*	Last Budget Action (Date, Ord. No.)
001	2062	Homeless Rapid Rehousing	\$6,000,000	(\$1,250,000)	IX-3	6/18/2019, 30286
001	NE	ADU Forgivable Loan Program	\$0	\$1,250,000	N/A	N/A
448	8497	City Housing Authority Reserve	\$15,142,384	(\$1,250,000)	X-67	8/13/2019, 30300
448	205F	Bridge Housing Communities	\$0	\$670,000	X-67	6/18/2019, 30286
448	2062	Homeless Rapid Rehousing	\$500,000	\$580,000	N/A	6/18/2019, 30286

*The 2019-2020 Proposed Operating Budget was adopted by City Council on June 18, 2019.

HONORABLE MAYOR AND CITY COUNCIL

August 29, 2019

Subject: Accessory Dwelling Unit Forgivable Loan Program and Appropriation Actions

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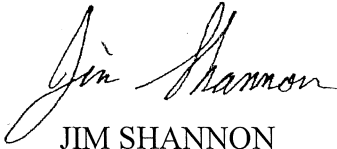
Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant impact to the environment.

/s/

JACKY MORALES-FERRAND
Director, Housing Department

/s/

ROSALYNN HUGHEY
Director, Department of Planning,
Building and Code Enforcement



JIM SHANNON
Budget Director

For questions please contact Jacky Morales-Ferrand, Director of Housing, at (408) 535-3855.