



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand
Margaret McCahan

SUBJECT: SEE BELOW

DATE: December 7, 2017

Approved

D. D. SyL

Date

12/8/17

SUBJECT: ACTIONS RELATED TO THE IMPLEMENTATION OF THE AFFORDABLE HOUSING IMPACT FEE AND INCLUSIONARY HOUSING ORDINANCE PROGRAMS

RECOMMENDATION

1. Adopt a resolution amending the 2017-2018 City of San José Schedule of Fees and Charges (Resolution No. 72737, as amended) to establish an In-Lieu Fee of \$158,343 per unit for rental developments subject to the Inclusionary Housing Ordinance Program effective January 1, 2018.
2. Adopt a resolution that amends Resolution No. 77218 as previously amended by Resolutions No. 78010 and 78392 (collectively the "Housing Impact Fee Resolution") to address the transition between the Affordable Housing Impact Fee and Inclusionary Housing Ordinance Programs providing that new rental projects whose applications for first approval are completed after January 31, 2018, will be subject to the Inclusionary Housing Ordinance; and that additional guidance will be provided in the regulations.
3. Direct staff to return to City Council with a resolution that establishes a reduction in the Inclusionary In Lieu Fee to \$0 (per in-lieu unit) as an incentive for high rise rental developments in the Downtown Core (as described in Resolution Number 73587 adopted January 9, 2007) that are ten (10) or more floors or stories in height not including any non-residential uses where the highest occupied floor has a floor level elevation is at least 150 feet above street level, if they obtain issuance of all certificates of occupancy on or prior to June 30, 2021.
4. Accept staff report and direct staff to bring to the City Manager for approval amendments to the Inclusionary Housing Ordinance Guidelines regarding (a) rental developments; (b) the transition from Affordable Housing Impact Fee including alternative process for projects built on land leased from a public agency; and (c) coordination with the existing Inclusionary Housing Policy.

OUTCOME

Approval of the recommended actions will establish the Inclusionary Housing Ordinance Rental In-Lieu Fee and clarify the transition from the Affordable Housing Impact Fee to the Inclusionary Housing Ordinance for new rental developments, thus allowing the Housing Department to implement the Inclusionary Housing Ordinance Program. This memorandum also recommends that the downtown high rise exemption will be retained.

BACKGROUND

Inclusionary Housing Ordinance

The Inclusionary Housing Ordinance, Chapter 5.08 of the San José Municipal Code, was adopted 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 or renters. The provisions of the Inclusionary Housing Ordinance that apply to rental developments were suspended until the court decision in *Palmer v. City of Los Angeles* was superseded. AB 1505, discussed below, supersedes this decision effective January 1, 2018. The Inclusionary Housing Ordinance provides alternative ways that a developer may meet the affordable unit requirement, including payment of an In-Lieu Fee and construction of affordable units off-site. When a developer selects an alternative to providing the units on the same site as the market rate units the requirement is increased to 20%. The In-Lieu Fee is calculated based on the 20% requirement. However, prior to the approval of AB 1505, the In-Lieu Fee for rental developments had not yet been established.

The Inclusionary Housing Policy in Redevelopment Project Areas

Since 1988, the City has administered the Inclusionary Housing Policy ("Policy"). The Policy generally requires that, in market-rate developments of 10 or more units, 20% of the units be made affordable to income eligible buyers/renters. The Policy offers alternative ways for developers to meet this requirement including payment of an in-lieu fee and construction of affordable units off-site.

On March 29, 2016, the City Council took action clarifying that the Inclusionary Housing Ordinance would supersede the Policy on the operative date, July 1, 2016. At that time, several non-exempt residential development projects in Redevelopment Project Areas were under review by the Department of Planning, Building, and Code Enforcement (PBCE). The Housing Department provided the following clarity regarding the inclusionary housing obligations for these projects:

- If a developer obtained all Planning Permits (other than a building permit) prior to June 30, 2016, the project would be subject to the Policy rather than the Inclusionary Housing Ordinance; and

- If a developer did not obtain all Planning Permits prior to June 30, 2016, the project would be subject to the requirements in the Inclusionary Housing Ordinance rather than the Policy, subject to the exemptions in the Inclusionary Housing Ordinance. Please see **Attachment A** for a copy of the City Council memorandum from March 29, 2016.

The Affordable Housing Impact Fee

On November 18, 2014, the City Council adopted the Housing Impact Fee Resolution, establishing the AHIF Program. Under the AHIF program, new market-rate rental housing developments are charged \$17.00 per square foot of net rentable space to address the impact of that type of development on the need for affordable housing. The resolution provided a grandfathering provision (Pipeline Exemption) open to projects with approvals completed before June 30, 2016. Twenty-nine developments were deemed eligible for the exemption. A development will be exempted from the fee if the development receives its Certificate of Occupancy for buildings containing at least 50% of the declared units prior to January 31, 2020. There are 6,486 exempted apartments with an estimated value of the exempted fee revenue for these developments that totals \$95.3 million.

The AHIF Program also includes a limited-time exemption for Downtown High-Rise rental projects. The Downtown High Rise Exemption allows a development to be exempted from paying the Fee, if all the following criteria are met:

1. The development is located in the specific Downtown Core Area, meets the Minimum Height requirement, and is not a for-sale development;
2. An Affordable Housing Plan is completed and approved;
3. An Affordable Housing Agreement is recorded which provides that the Fee shall apply in the event the Developer fails to satisfy all exemption requirements; and
4. The project receives its Certificate of Occupancy on or before June 30, 2021.

To date, four developments have qualified for the Downtown High-Rise Exemption, providing 1,200 apartments. The estimated value of the exempted fee totals \$15.0 million.

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 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 September 29, 2017, the Governor signed AB 1505, thus clarifying the Legislature's intent to supersede the court decision in *Palmer v. City of Los Angeles* and allowing Inclusionary Housing Ordinance's requirements to apply to rental developments effective January 1, 2018. On October 24, 2017, the Housing Department provided the City Council with a report regarding potential changes to the Affordable Housing Impact Fee ("AHIF") and Inclusionary Housing Ordinance Programs and the impact of Assembly Bill ("AB") 1505 on those programs. During that City Council meeting, the Housing Department identified the need to return to the City Council to:

1. establish the In-Lieu Fee within the Inclusionary Housing Ordinance Program; and
2. clarify the transition between the Affordable Housing Impact Fee and Inclusionary Housing Programs for new rental developments.

The question of how to impose inclusionary housing requirements on projects of 3-19 units was also discussed at the City Council meeting on October 24, 2017. The Housing Department is conducting further analysis and will be returning to City Council with a recommendation in spring 2018.

ANALYSIS

Establishment of the Rental In-Lieu Fee within the Inclusionary Ordinance Housing Program

Most inclusionary programs provide developers flexibility in how they can satisfy their inclusionary housing requirement. The most common option is to pay a fee in-lieu of producing the affordable apartments on-site. In-lieu fees are used to fund affordable housing developments. The City's Inclusionary Housing Ordinance provides a range of alternative options including off-site construction, in-lieu fee payment, land dedication, and the ability to obtain credits for additional units produced.

The methodology for establishing the rental In-Lieu Fee for residential rental development is defined in Section 5.08.520 of the Inclusionary Housing Ordinance. The Housing Department recommends approval of an In-Lieu Fee of \$158,343 per affordable unit, which is intended to be in effect through June 30, 2019. For example, if a development has 100 apartments, the In-Lieu Fee is based on 20% of the total apartments. The In-lieu Fee calculation would be $20 \times \$158,343$ for a total cost of \$3,166,860. The proposed Inclusionary Rental In-Lieu Fee is higher than the AHIF fee, however, it is comparable to the For-Sale In-Lieu Fee of \$153,426. This is because the fee calculation is designed to provide sufficient revenue to replace the affordable apartment that the developer has chosen not to build. The AHIF fee is based on the demand that is created for affordable housing as a result of the development of market rate housing.

When establishing the In-Lieu fee it is important to consider whether the City wants to encourage on-site development to promote economic integration, or if it prefers to obtain fee revenue to fund affordable housing development. If the In-Lieu Fee is set too low, developers will consistently opt out of building the affordable apartments. A low fee may not be sufficient to

replace the developer's obligation. Given the current housing crisis, the lack of a local on-going funding stream, and the challenge in finding land to construct units not produced by the developer, it is essential to ensure that the fee is sufficient so that the affordable apartment is built. If the fee is too high, developers will either build the apartments within their developments or select another compliance option.

Initial Calculation of the Rental In-Lieu Fee

Under Section 5.08.520, the In-Lieu Fee for each rental inclusionary unit shall be no greater than the average city subsidy required for new construction of a rental residential unit at an Affordable Housing Cost for a Lower Income Household.

To establish the initial rental In-Lieu Fee, the Housing Department used data from the last three (3) City-subsidized affordable housing rental developments that achieved construction closings, then applied the following methodology:

1. Calculated the sum of City subsidies required for new construction of affordable rental residential units at an Affordable Housing Cost for a Lower Income Household within the three projects identified;
2. Calculated the total number of restricted units within the three projects identified;
3. Divided the total subsidy figure by the total number of units to obtain the average City subsidy per constructed unit required to create the affordable apartments; and
4. Multiplied the average subsidy by 3.8% to account for the estimated cost of increases in the price of housing and construction from the time of payment of the In-Lieu fee to the estimated time for funding of the affordable units by the City (2 years). The 3.8% inflation factor was derived by utilizing the Consumer Price Index (CPI), as published by the U.S. Bureau of Labor Statistics on September 14, 2017, for the past 12-month period (+1.9%) and applying this annual figure to an anticipated 2-year delay.

The final figure equals the average City subsidy per unit. This figure shall be applied to the number of units for which the In-Lieu Fee shall be collected (20% of all units in the residential development). **Attachment B** illustrates the Rental In-Lieu Fee calculation, consistent with Section 5.08.520.

Annual Updates to the Calculation of the Rental In-Lieu Fee

To update the In-Lieu Fee, the Housing Department shall identify the three (3) most recent projects with construction closings in the reporting period (the prior calendar year) and utilize the described methodology to calculate a new recommended fee amount. The updated fee shall be made effective July 1 of the fiscal year as approved by City Council's adoption of the Fees and Charges Report. In the event that there are fewer than three (3) city-subsidized rental affordable housing new construction projects within any twelve (12) month reporting period, the In-Lieu Fee shall be updated annually using the change in the Northern California Real Estate Construction Report published by the Real Estate Research Council of Southern California at California State Polytechnic University, Pomona. After the initial fee period, the Administration

will make a recommendation as part of the Administration's Proposed Fees and Charges Report during the budget process.

Transition between AHIF and Inclusionary Housing Ordinance

The Inclusionary Housing Ordinance, by its terms, will apply to all rental projects receiving first approvals after January 1, 2018. The AHIF also applies to these projects. Staff is recommending a 30-day transition period between the two programs based on the date an application is complete and ready for first approval to determine if an in-process application will continue having the AHIF applied or default to the Inclusionary Housing Ordinance requirements. This would be consistent with prior outreach, provides predictability for developers and accommodates projects that are already in process. The criteria by which the AHIF would continue to apply during this 30-day transition period for a residential rental project include the following:

1. The developer or the rental development has submitted a complete executed Planning Application for first approval and has paid all planning application fees to the Department of Planning, Building, and Code Enforcement ("PBCE") by January 31, 2018;
2. The application for first approval is for a Conditional Use, Planned Development, Site Development, or Special Use Permit;
3. The developer has submitted a completed Compliance Plan Application, acquired Housing Department approval, paid the associated fee of \$3,200, and entered into an affordable housing agreement¹ regarding these transition terms or, if eligible, enters into a downtown high-rise exemption agreement, no later January 31, 2018; and
4. The developer obtains issuance of the project's Building Permits, and pays the then current Housing Impact Fee prior to January 31, 2020.

Any project with an approved Affordable Housing Compliance Plan that has already entered into a recorded Housing agreement and pulled building permits shall be subject to the AHIF, including projects in the AHIF Pipeline Exemption process.

Downtown High-Rise Exemption

As noted earlier, the AHIF program contains an exemption for downtown high-rise rental developments. The high-rise exemption was instituted as an incentive due to the height restriction over downtown, high costs of steel construction, high land prices, rising labor costs, and stabilizing rents. These factors make building high-rise developments in the downtown much more challenging. **Attachment C** provides a list of all high rise developments in the downtown, their proposed tenure, the program that applies to the development, the fee amount, and indicates whether the development is exempted.

¹ The agreement will stipulate that if the developer does not meet all criteria described in this section, the project will be subject to the Inclusionary Housing Ordinance.

The Inclusionary Housing Ordinance contains a provision which specifically allows that the In-Lieu Fee may be reduced for High Rise Residential Development in any specified area of the City by City Council resolution or policy, providing incentives for the provision of high density Residential Development. The development must be located in the Downtown Core, (as described in Resolution Number 73587 adopted January 9, 2007) and be at least ten (10) or more floors or stories in height. The height requirement does not include any non-residential uses where the highest occupied floor has a floor level elevation is at least 150 feet above street level. Staff recommends maintaining the high-rise exemption consistent with the AHIF and will return in January 2018 with a resolution.

Qualifying Affordable Projects on Public Land

Per City Council direction received prior to the adoption of AB 1505, the Housing Department considered proposed amendments to the AHIF Program that would provide developers of certain types of projects on leased public land with an alternative method of reducing their required AHIF by providing affordable apartments onsite. Staff is recommending for developers that choose to voluntarily build affordable units onsite, projects must meet all the following conditions:

- be located on public property;
- have a covenant recorded by a public agency that requires the project to include units affordable to low, very low, and extremely low-income residents; and
- be on land that the agency is leasing for residential development.

Existing obligations of a public agency landowner to provide affordable units on-site may result in more affordable units being developed than under the current AHIF Program requirement. In this case, after the adoption of AB 1505, the best alternative method for projects where the underlying land is owned by a public agency and subject to public agency covenants, would be to allow those projects to voluntarily elect to comply with the Inclusionary Housing Ordinance instead of paying the AHIF.

Projects Subject to the Inclusionary Housing Policy

As noted in this memorandum, the Inclusionary Housing Ordinance will apply to rental developments effective January 1, 2018, and was applied to for-sale developments in July 1, 2016. There may be developments that remain subject to the Policy because they obtained all Planning Permits prior to June 30, 2016, but they have yet to obtain a Building Permit. Due to the need to implement the Inclusionary Housing Ordinance for all rental developments, staff is recommending that as of January 1, 2018, any rental project subject to the Policy that has not obtained a Building Permit by December 31, 2017, will be subject to the Inclusionary Housing Ordinance, subject to the exemptions in that Ordinance. The provisions regarding this transition will be implemented in the Inclusionary Housing Ordinance guidelines.

EVALUATION AND FOLLOW-UP

If City Council approves staff recommendations as outlined in this memorandum, the Housing Department will amend the AHIF regulations consistent with this memorandum. The Housing Department will submit to the City Manager for approval, the amended guidelines for the Inclusionary Housing Ordinance. Lastly, the Housing Department will return in January with a resolution that provides an exemption for downtown High-Rise developments.

POLICY ALTERNATIVES

Alternative #1: *Do not accept the Housing Department's recommendation for providing a transitional period for developments subject to the Inclusionary Housing Ordinance as of January 1, 2018.*

Pros: More developments would be subject to the Inclusionary Housing Ordinance, which could lead to greater revenue, if developers choose to pay the In-Lieu Fee option to satisfy a project's Inclusionary Housing obligation.

Cons: Developers would have limited time to adjust for Inclusionary Housing Ordinance requirements within their projects, and this may impact developers' ability to move forward with their projects.

Reasons for not Recommending: The actions in this memorandum do not recommend any additional exemptions from either the AHIF or the Inclusionary Housing Ordinance. Allowing a transitional period offers a reasonable effort to mitigate impacts to the development community, while ensuring implementation of the Inclusionary Housing Ordinance.

Alternative #2: Lower the In-Lieu Fee below the \$158,343 per affordable unit.

Pros: A lower In-Lieu Fee will incentivize developers to pay the fee instead of building the affordable apartments on-site. A lower fee would make it easier for a developer to meet the IHO requirements. The Housing Department has a strong lending team who will be able to use the revenue to fund 100% affordable housing developments that will target lower income households.

Cons: Lowering the fees will result in the production of fewer affordable apartments during a time when there is an overwhelming need for housing. Also, if the fee incentivizes developers to consider building on-site, the income targets will be 9% at 80% of the area median income and 6% at

60% of the area median income. The 80% restricted apartments, targeting incomes at \$59,700 for a one-person household, provide a greater range of housing options for households that do not typically qualify for affordable housing. Lastly, integrating affordable apartments within a market development creates economic integration

**Reasons for not
Recommending:** The shortage of land for development of affordable housing and the social benefits of economic integration make this alternative undesirable.

PUBLIC OUTREACH

On October 13 and November 15, 2017, the Housing Department hosted an outreach meeting to members of the development community and other stakeholders to discuss the implementation of the Inclusionary Housing Ordinance. An estimated 22 and 19 attendees were present at these meetings, respectively. On October 20, 2017, the Housing Department attended Planning, Building, and Code Enforcement's Developers Roundtable meeting and provided an input to more than 30 attendees. Finally, this memorandum will be posted on the City's Council Agenda website for the December 19, 2017 Council Meeting.

COORDINATION

This item has been coordinated with the City Attorney's Office and the Office of Economic Development.

COMMISSION RECOMMENDATION/INPUT

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

COST IMPLICATIONS

There are no revenue or expense impacts in 2017-2018. Costs of assessing the fee will be covered by the current resources used to assess the AHIF. The revenue generated by the Impact Fee will decrease until all eligible projects are completed or until January 1, 2020 when projects roll over to the In-Lieu Fee. The Inclusionary Rental In-Lieu Fee is assessed at time of Occupancy Permit issuance for new projects submitted starting January 1, 2018 and that revenue will be recognized in the year which those permits are anticipated to be issued. It is anticipated that additional revenue for affordable housing would be generated under the In-Lieu fee for rental units should developers choose to pay the fee instead of otherwise meeting the affordable

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unit requirement. As illustrated in **Attachment D**, the AHIF, based on the assumptions that the development has 100 units and each unit is 1,000 square feet, would generate \$1.7 million. In 2018, if the same development were to pay the Rental In-Lieu Fee, the amount collected to build the 20 units would be \$3.2 million.

CEQA

Not a Project, 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



MARGARET MCCAHAN
Budget Director

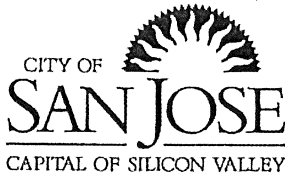
For questions, please contact Patrick Heisinger, Division Manager, at (408) 975-2647.

Attachment A– City Council memorandum from March 29, 2016

Attachment B – Calculation of the Rental In-Lieu Fee Compliance Option

Attachment C – Downtown High Rise Developments

Attachment D - Example of Market-Rate Project Paying the AHIV vs the Rental In-Lieu Fee



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: IMPLEMENTATION OF THE
INCLUSIONARY HOUSING
ORDINANCE

DATE: March 17, 2016

Approved:

Date

3/17/16

RECOMMENDATION

Adopt a resolution:

1. Updating the findings for the Inclusionary Housing Ordinance (“Ordinance”); and
2. Directing staff to implement a grace period in the Inclusionary Housing Guidelines for projects subject to the Ordinance, providing an exemption from its requirements if all Planning Permits needed for the project are obtained by June 30, 2016.

OUTCOME

The City Council’s consideration of the items discussed in this memorandum will provide an update to the existing findings for the Ordinance and provide the Housing Department with the additional guidance to facilitate the implementation of the Ordinance by providing a grace period.

BACKGROUND

On January 12, 2010, the City Council approved the Ordinance. The Ordinance included a provision that it would become operative on January 1, 2013. This was intended to provide the development community with three years from the date of adoption to plan for implementation of the Ordinance requirements and to recover from the downturn in the economy.

The Ordinance generally requires that, in market-rate for-sale developments of 20 or more units, 15% of the units be made affordable to and sold to moderate-income households. The Ordinance provides numerous alternative ways that the developer can meet this requirement, including payment of an in-lieu fee and construction of affordable units off-site, among many others. Attachment A provides a summary of the Inclusionary Housing Ordinance requirements.

Although the 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 by a court of competent jurisdiction or State legislation changes applicable law.

Legal Challenge to the Inclusionary Housing Ordinance

Although the Ordinance was operative on January 1, 2013, its implementation was prevented by an injunction imposed by the Santa Clara County Superior Court, resulting from a challenge submitted by the California Building Industry Association (CBIA), in *California Building Industry Association v. City of San José*. That injunction was terminated when the Superior Court's decision invalidating the ordinance was overturned by the 6th District Court of Appeal, the ordinance was held to be valid, and the case was remanded to the Superior Court to render a decision consistent with the decision of the Appellate Court. However, CBIA appealed the decision further to the California Supreme Court. On June 15, 2015, the California Supreme Court issued its decision unanimously affirming the Court of Appeals' determination that the Inclusionary Housing Ordinance is valid, and remanding the case to the trial court for a determination consistent with the higher courts' direction. This decision became final on July 15, 2015.

On September 14, 2015, the CBIA filed a petition for a writ of certiorari with the U.S. Supreme Court seeking review of the California Supreme Court's unanimous ruling that upheld the City's Ordinance. On February 29, 2016, the Supreme Court declined to hear that petition.

ANALYSIS

Updated Findings Supporting the Ordinance

Since approval of the Ordinance on January 12, 2010, housing costs have escalated sharply, increasing faster than incomes for many San José households and the City has lost its primary funding source for affordable housing, the 20% affordable housing set-aside from the tax increment collected by the former Redevelopment Agency. Even before the Agency was dissolved in early-2012, the City was falling short of meeting its Regional Housing Needs Allocation (RHNA) established by the Association of Bay Area Governments. In the 2007-2013 period, only 2,956 affordable units began construction, or 15% of the 19,271-unit RHNA goal. This overall 15% figure masks the components by income level: 23% of the goal for extremely low- and very low-income (ELI and VLI) need was met, 20% of the low-income (LI) goal was met, but only 2% of the moderate-income (Mod) goal was achieved.

The City's RHNA for the period between January 1, 2014 and October 31, 2022 identifies the need to plan for 20,849 new affordable housing units. In the first two years of this period through the end of 2015, construction began on 576 affordable units, all at ELI/VLI/LI levels and none in the moderate-income category. This rate of development falls far short of the 2,382 units annually that would be required to meet the RHNA goal for affordable units.

Since the Ordinance is designed to produce moderate-income units, it could help fill a long-standing and continuing gap in the production of affordable, moderate-income housing units to help meet the City's RHNA goals to the extent market-rate developers do not pay fees in lieu of providing the affordable units.

State housing policy requires the City to assist in the development of adequate housing to meet the needs of low- and moderate-income households. As discussed above there is a significant shortage of housing affordable to low and moderate income households, which will only increase as the finite number of residentially zoned lots within the City are purchased and developed for market rate residential developments. This loss of residential land available for affordable housing is another impact of market rate residential development.

The City's Envision San José 2040 General Plan recognizes that affordable housing is a critical component to the City's economic and social health. The Ordinance is consistent with the adopted goals and policies contained in Envision 2040, including the following policies and goals: H-1.2, H-1.6, H-1.9, H-1.10, H-2, H-2.1, H-2.8, H-2.11, H-3.3 and H-4.2. As specified in Goal H-2, it is in the interest of public welfare, health and safety that at least fifteen percent (15%) of new residential dwelling units be affordable units.

In addition to locally adopted policies, development of affordable housing units in conformance with the Ordinance will help to increase the supply of affordable housing implements policies of the State of California to: (1) provide sufficient capacity for new housing affordable at all income levels necessary to accommodate the State's future economic growth; and (2) by providing housing for moderate-income retail and service workers, the need for long commutes from less expensive housing markets can be reduced and thus contribute to the implementing the Global Warming Solutions Act of 2006 and the Sustainable Communities and Climate Protection Act of 2008.

Grace Period Before Ordinance Becomes Operative

The California Supreme Court's decision became final on July 15, 2015, and, as a result, the City could begin requiring that all non-exempt projects comply with the Ordinance as of that date. However, the Housing Department recommends that the City provide a grace period with respect to the Ordinance requirements for projects that have acquired all of their Planning Permits on or before June 30, 2016 for the following reasons:

1. The June 30, 2016, date provides extra time for Staff to provide additional notice and outreach to the development community; and
2. The June 30, 2016, implementation date would provide Staff with sufficient time to notify the development community, prepare implementation guidelines, agreements, other relevant documents, and tracking systems necessary to implement the Ordinance.

The June 30, 2016 implementation date has been closely coordinated with the Department of Planning, Building and Code Enforcement.

In the numerous meetings that the Housing Department has held with market-rate, for-sale housing developers (see the PUBLIC OUTREACH section of this memorandum, below), staff has provided notice that this would be end of the grace period that would be recommended to the City Council.

If the City Council accepts this recommendation, Staff will prepare a section for the Inclusionary Housing Ordinance Administrative Guidelines ("Guidelines") exempting residential projects otherwise subject to the Inclusionary Housing Ordinance requirements if they received all Planning Permits needed for the project prior to June 30, 2016. The Ordinance defines a "Planning Permit" as a tentative map, parcel map, conditional use permit, site development permit, planned development permit, development agreement, or special use permit, or any discretionary permit excluding general plan amendments, zoning and rezoning, annexation, specific plans, and area development policies.

Creation of Inclusionary Housing Program Guidelines and the Inclusionary Housing Compliance Plan Application

The adoption of Guidelines is a requirement of the Ordinance. The City Manager has delegated the responsibility for enforcement of the Ordinance to the Director of Housing. The Director of Housing will adopt Guidelines to assist in the implementation and administration of all aspects of the Ordinance. The Guidelines will provide staff and the residential development community with more specific information about the application process, implementation, interpretation, and compliance with the Ordinance. The Housing Department, with the assistance of Department of Planning, Building and Code Enforcement and the City Attorney's Office, will draft and publish the Guidelines by May 1, 2016.

Interested parties may locate the Inclusionary Housing Compliance Plan Application on the Housing Department's website at www.sjhousing.org.

Coordination with the Inclusionary Housing Policy in Redevelopment Project Areas

Since 1988, the City has administered the Inclusionary Housing Policy ("Policy") which requires that twenty percent (20%) of all new market rate for-sale developments of 10 or more units located in Redevelopment Project Areas be price-restricted and sold to moderate-income purchasers. This requirement continues despite the dissolution of the Redevelopment Agency. Pending Council's approval of staff's recommendations, the Ordinance will supersede the Policy requirements for any projects that do not have all Planning Permits approved prior to June 30, 2016. The Guidelines will address the mechanics of this change in greater detail.

Several non-exempt residential development projects in Redevelopment Project Areas are currently under review by PBCE. If the Developer obtains all Planning Permits prior to June 30, 2016, that project will be subject to the Policy rather than the Ordinance. Projects that have not

obtained all Planning Permits approved prior to June 30, 2016 will be subject to the Ordinance's requirements, subject to the exemptions in the Ordinance.

EVALUATION AND FOLLOW-UP

The Housing Department will return to the City Council with updates regarding the implementation of the Ordinance, as needed.

POLICY ALTERNATIVES

Alternative #1: *Implement the Ordinance without a grace period*

Pros: An increased number of for-sale residential developments would be subject to the Ordinance, which would lead the creation of more price-restricted homes.

Cons: The residential development community would not have the additional time to respond to the implementation of Ordinance. Additionally, staff requires time to address issues related to administration of the Ordinance.

Reason for not recommending: This will provide staff with additional time to complete the Guidelines and the development community to adjust to the requirements of the Ordinance.

PUBLIC OUTREACH

Since January 18, 2015, the Housing Department has provided comments to Planning staff and developers regarding the potential applicability of the Ordinance and/or the Policy on all residential development applications. The Housing Department interfaces with both Planning staff and developers throughout the entitlement process. Staff monitors each project and attaches a condition of approval for the appropriate affordable housing program, if applicable, prior to the project's approval hearing.

Since the California Supreme Court's ruling, staff has conducted extensive outreach to the Development community. On June 26, 2015, the Housing Department issued a notice to nearly 600 individuals and organizations about the Court's ruling that upheld the City's Ordinance. In that notice, the Housing Department informed interested parties that a series of outreach meetings about the implementation of the Ordinance would be conducted. The Housing Department has hosted 15 such meetings to date and has scheduled an additional seven meetings before July 1st.

In addition to notifying Developers and hosting community meetings, the Housing Department has attended three Developers and Construction Roundtable Meetings hosted by the Department of Planning, Building, and Code Enforcement and made a presentation at a Building Industry Association (BIA) meeting on October 15, 2015.

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Finally, this memorandum will be posted on the City's Council Agenda website for the March 29, 2016 City Council meeting.

COORDINATION

Preparation of this report was coordinated with the Department of Planning, Building and Code Enforcement, the City Attorney's Office, and the City Manager's Budget Office.

COMMISSION RECOMMENDATION

The Housing Department has provided the Housing and Community Development Commission (HCDC) with multiple updates on the Ordinance. Additionally, on March 10, 2016, the HCDC will consider the recommendations being made in this memorandum and a supplemental report on their action will be submitted to the City Council, as needed.

FISCAL IMPACT

There are no fiscal impacts directly associated with the recommendations discussed in this memorandum. However, due to the anticipated number of Inclusionary Housing Compliance Plan Applications that will need to be processed, it is anticipated that the Housing Department will recommend staffing additions, and associated Fees and Charges adjustments, to administer the Ordinance as part of the City's FY 2016-2017 budget process. The Ordinance authorizes the collection of fees to cover the cost of administration.

CEQA

Determination of Consistency to the Final Program EIR for the Envision San José 2040 General Plan and Supplemental EIR (SCH# 2009072096). File No. PP16-025.

/s/
JACKY MORALES-FERRAND
Director, Housing Department

For questions, please contact Patrick Heisinger, Senior Development Officer, at (408) 975-2647.

Attachment A

ATTACHMENT A

Requirements of the Inclusionary Housing Ordinance

The Inclusionary Housing Ordinance requires that all new for-sale residential developments of 20 or more units include housing that is affordable and price-restricted for moderate-income purchasers. Developers may satisfy their Inclusionary Housing Requirement by:

1. Designating 15 percent of the units on-site in the project as affordable; or
2. Implementing a variety of Developer options including:
 - construction of off-site affordable units equal to 20 percent of the original project's units,
 - payment of the in-lieu fee,
 - dedication of qualifying land in lieu of construction,
 - purchasing surplus inclusionary housing credits from another Developer,
 - the acquisition and rehabilitation of existing units,
 - providing deed-restricted units that are available to lower income households through an agreement between the Developer and the U.S Department of Housing and Urban Development, or
 - any combination of these methods that will achieve the requisite amount of affordable housing.

Exemptions

Residential projects that meet the criteria in Inclusionary Housing Ordinance Section 5.08.320 will be exempt from the Inclusionary Housing Ordinance requirements. Generally speaking, the Inclusionary Housing Ordinance provides that residential projects will be exempted when:

1. There are fewer than 20 units;
2. Tentative map application was deemed complete before January 1, 2013 or otherwise exempted by California Government Code section 66474.2 or 66498.1;
3. Included in a Development Agreement effective prior to January 1, 2013 and compliant with any affordable housing requirements in the Development Agreement;
4. Residential Developments for which a Planning Permit has been approved by the City prior to January 1, 2013;
5. Included in a phased pre-1993 Specific Plan area that is not in Redevelopment Project Area where one or more phases were completed prior to January 1, 2013.

ATTACHMENT B

Calculation of the Rental In-Lieu Fee Compliance Option

	A	B	C	D	E
Closing Date	Project	City Subsidy	# of Units	City Subsidy per Unit	3.8% Increase Due to Delay*
04/25/2016	Met South	\$3,735,000	30	\$124,500	
12/12/2016	2 nd Street Studios	\$16,915,713	134	\$126,237	
03/17/2015	Met North	\$15,045,000	70	\$214,929	
	Totals	\$35,695,713	234	\$152,546	\$158,343

[Total City Funding Committed to Affordable Housing Developments]	\$35,695,713
	÷
[Divided by the Total Number of Units]	234

	=
[Fee per Inclusionary Unit]	\$152,546
	+
[3.8% Increase Due to Delay*]	\$5,797

	=
In-Lieu Fee Per Affordable Unit	<u>\$158,343</u>

* To account for the estimated cost of increases in the price of housing and construction from the time of payment of the In-Lieu fee to the estimated time for funding of the affordable units by the City (2 years).

Attachment C: Downtown High Rise

Project Name	Address	Permit #	Tenure	Program	Exempt	Comp. Plan In	Date of First Approval	Calculated Obligation AHIF or Inclusionary In Lieu (FY 17-18 \$17.41)	# on Units	Gross Sq Ft
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Projects that have Submitted Affordable Housing Compliance Plan

Gateway Tower	455 S. First	H15-047	Rental	AHIF	Y - DT High Rise	Y	12/6/16	\$4,096,660	300	235,305
Miro (SJSC Towers)	4th and Santa Clara	SP17-009	Rental	AHIF	Y - DT High Rise	Y	3/15/17	\$10,232,344	630	587,728
The Graduate	80 E San Carlos St	H16-036	Rental	AHIF	Y - DT High Rise	Y	3/22/17	\$4,551,601	260	261,436
Museum Place	180 Park Ave	H16-024	For Sale/Rental	Development Agreement	Y - DA	Y	8/29/17	TBD - mix of rental/for-sale	306	298,069
NSP Tower 3	201 W Julian Street	H14-037	Rental	Development Agreement	Y - DA	Y	8/5/15	\$4,276,679	313	245,645
Park View Towers	252 N. 1st Street	H14-009	Rental	Development Agreement	Y - DA	Y	6/23/15	\$4,307,147	220	247,395
Post & San Pedro	171 Post St	H14-023	Rental	IH Policy	N	Y	10/8/14	\$3,080,859	228	181,227
Silvery Towers	190 W St James St	H13-041	For Sale	IH Policy	N	Y	2/26/14	\$5,322,471	640	626,173
Aviato	199 Bassett Ave	SP17-023	For Sale	IHO	N	Y	11/17/17	\$9,205,560	302	285,612
Greyhound	70 S. Almaden	SP16-021	For Sale	IHO	N	Y	5/23/17	\$21,786,492	708	701,473

\$66,859,814

Projects that have NOT YET Submitted Affordable Housing Compliance Plan

27 West	27 S. 1st Street	H17-027	N/A	TBD	TBD	N	None	Unknown	342	Unknown
4th St Metro Station	439 S. 4th Street	H17-004	N/A	TBD	TBD	N	4/19/16	Unknown	101	Unknown
715 W. Julian	715 W. Julian	C17-031	N/A	TBD	TBD	N	None	Unknown	125	Unknown
Davidson Tower	255 W. Julian	PRE16-077	N/A	TBD	TBD	N	None	Unknown	654	Unknown
Garden Gate	600 S. 1st Street	PRE17-102	N/A	TBD	TBD	N	None	Unknown	285	Unknown
Park & Almaden	170 Park Center Plaza	H17-050	N/A	TBD	TBD	N	None	Unknown	260	Unknown
Sobrato Block 3	150 S. 2nd Street	H16-033	N/A	TBD	TBD	N	None	Unknown	393	Unknown

ATTACHMENT D

Example of Market-Rate Project Paying the Affordable Housing Impact Fee vs the Rental In-Lieu Fee

	Rental In-Lieu Fee	Affordable Housing Impact Fee
# of Market-Rate Units in Project	100 at 1,000 sq. ft./unit	100 at 1,000 sq. ft./unit
Inclusionary Obligation	20% - due to in-lieu fee	n/a
# of Inclusionary Units	20	n/a
Current Fee	\$158,343/unit	17.41/sq. ft.
Total Rental Fee for Project	\$3,166,860	\$1,741,000
Timing of Fee Payment	Prior to City issuance of a certificate of occupancy	Prior to City issuance of a building permit