CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Erik L. Soliván

SUBJECT: **See Below**

DATE: January 14, 2026

Approved Date: 1/16/26

COUNCIL DISTRICT: Citywide

SUBJECT: Amendments to Chapter 5.08 of Title 5 of the San José Municipal Code and Regulations for the Inclusionary Housing Ordinance

RECOMMENDATION

Approve an ordinance amending Chapter 5.08 (Inclusionary Housing) of Title 5 of the San José Municipal Code to:

(a) Update affordability levels;
(b) Refine compliance options (including Surplus Credits);
(c) Align the affordability term for inclusionary units with state practice; and
(d) Clarify treatment of 100% affordable developments.

SUMMARY AND OUTCOME

Approval of the amendments to the Inclusionary Housing Ordinance (IHO) will align affordability requirements with current market conditions and enhance the feasibility of unsubsidized market-rate and mixed-income projects while still delivering meaningful affordability outcomes for middle-income households. The amendments will:

- Simplify compliance with clearer options and definitions and implement a functional Surplus Credits marketplace.
- Align affordability terms for inclusionary rental units with state practice.
- Further streamline 100% affordable projects by providing a simple, enforceable compliance mechanism.

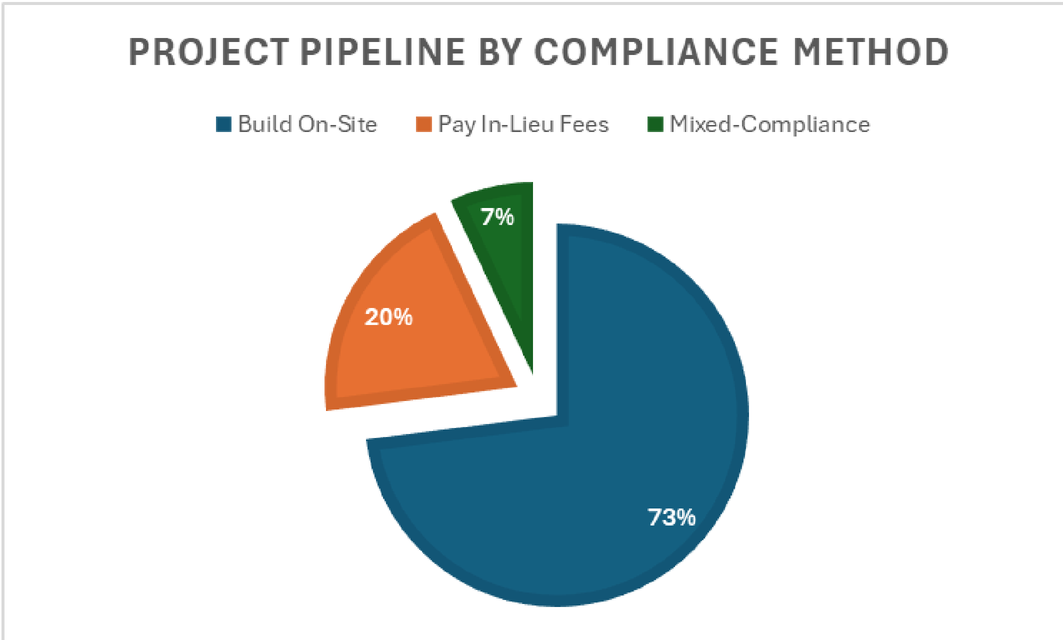
Collectively, these changes would make the IHO clearer, more predictable, and better aligned with financing realities, supporting housing abundance and the production of housing for San José's workforce.

BACKGROUND

Since its establishment, the IHO has produced affordable workforce housing across San José, and there are opportunities for improvement in program administration in order to convert more applications into construction units. Historically, less than 10% of projects subject to IHO requirements have advanced from application to construction, with 43 completed projects delivering 1,442 inclusionary units. Of these units, 43% are at 50% Area Media Income (AMI) and 56% are at 60-110% AMI. The IHO was revised in 2010, 2019 and 2021 to add multiple compliance options and modernize requirements.

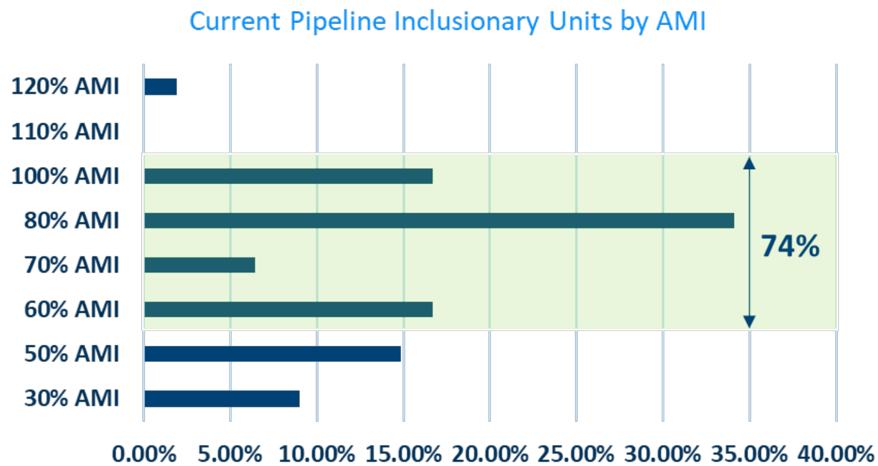
Since the March 2021 IHO update, the Housing Department has received over 260 development applications. The current pipeline of applications includes 73 projects that are seeking City of San José (City) approval or under construction representing 12,900 total units of which 1,900 units are affordable. As shown in Figure 1**,** of the 73 projects, 53 projects or 73% are building affordable units on-site. Another 15 projects or 20% of the projects selected to pay in-lieu fees only, while the remaining 7% of projects are utilizing mixed compliance. Total in-lieu fees collected from 15 projects total approximately $50 million. Projects under the 100% Affordable Compliance Option are excluded, as they follow a separate approval process.

Figure 1: Project Pipeline By Compliance Method



The on-site unit affordability levels for these projects are predominantly targeted toward households within the workforce income range. Across the 73 projects in the pipeline, an estimated 1,850 affordable units are planned on site, and a majority of those homes are targeted to households earning 60% to 100% of AMI. These are income levels that can be served without substantial public subsidy and correspond to middle-income households in San José, including teachers, nurses, and other middle-income earners. A smaller share of projects proposes mixed compliance (a blend of on-site units and fees), representing 45 on-site affordable units and $12.4 million in fees. Projects proposing fee-only compliance account for approximately $38.2 million in total fees. Figure 2 shows that 74% of all inclusionary units in the current pipeline are targeted to middle-income households (60% to 100% AMI).

Figure 2: Current Pipeline Inclusionary Units by AMI



This pattern shows two important dynamics. First, feasibility in today's environment is fragile: only about 28% of initial applications filed since 2021 are still active, reflecting the impact of high land costs, construction costs that are roughly double national averages, and interest rates near 7%, all of which have made it significantly harder for projects that were feasible in 2021 to remain viable in 2025. Second, when projects do remain viable, they overwhelmingly attempt to produce deed-restricted workforce units on site within the 60% to 100% AMI range rather than rely solely on fee payment. In other words, the private development pipeline is currently the City's most immediate, scalable source of mixed-income housing, including workforce housing, if those projects can continue to move forward.

Because the current IHO was not built for today's conditions and can constrain market-rate feasibility, the City Council-approved Mayor's March Budget Message for Fiscal Year 2025–2026 directs staff to streamline requirements, encourage on-site homes affordable to 60% to 120% AMI, and eliminate arduous regulatory processes for 100% affordable projects at or below 100% AMI.

These proposed changes are intended to:
(1) keep more projects financially feasible so they do not drop out of the pipeline; and
(2) make it easier for those projects to deliver on-site, income-restricted workforce units rather than default to fee payment.

Additionally, staff identified a way to add another tool to the mixed-compliance mix by activating a dormant provision of the IHO, the Surplus Credit Exchange.

ANALYSIS

The proposed policy shift is to build more units on-site across the AMI scale to foster mixed-income communities and abundant housing stock.

Changes to Affordability Levels (San José Municipal Code § 5.08.500, 5.08.510)

To align the IHO with today's financing realities and the City Council-approved Mayor's March Budget Message for Fiscal Year 2025–2026 direction, staff proposes amendments that recalibrate affordability targets to the 60% to 120% AMI "workforce" band, simplify compliance, and preserve a clear preference for on-site, mixed-income production. The focus is on households that earn too much for deeply subsidized housing but cannot afford market prices.

Tables 1 and 2 below summarize the current income targeting requirements under the IHO and the proposed changes.

Table 1: Current and Proposed Income Levels for the On-site Compliance Option

Option	Current	Proposed
Rental	5% at 50% AMI 5% at 60% AMI <u>5% at 100% AMI</u> 15% total OR 10% at 30% AMI	5% at 60% AMI 5% at 80% AMI <u>5% at 110% AMI</u> 15% total
For-Sale	15% at 120% AMI (maximum sales price at 110% AMI)	15% at 120% AMI (maximum sales price at 120% AMI)

- **On-site rental:** Moves affordability bands modestly into workforce ranges (60/80/110% AMI) and removes the 10% Extremely Low-Income alternative that is not financeable in most market-rate capital stacks today.

- **On-site for-sale:** Continues to serve moderate-income home buyers (15% at 120% AMI) while adjusting the price cap from 110% to 120% AMI to reflect cost realities and market constraints to spur more affordable homeownership development.

Table 2: Current and Proposed Income Levels for the Off-site Compliance Option

Option	Current	Proposed
Rental	10% at 50% AMI 5% at 60% AMI <u>5% at 100% AMI</u> 20% total	10% at 60% AMI 10% at 80% AMI <u>10% at 100% AMI</u> 30% total
For-Sale	20% at 120% AMI (maximum sales price at 110% AMI)	25% at 110% AMI (maximum sales price at 110% AMI)

- **Off-site (rental and for-sale):** Applies to the same workforce bands and increases total affordable shares to maintain a strong policy preference for on-site, mixed-income development outcomes.

Very deep affordability at 30% AMI inside market-rate buildings prohibit financial feasibility under current financing structures. Centering inclusionary targets in the 60% to 120% AMI band keeps projects financeable while still delivering affordability where most working households struggle. The City will continue delivering the deepest subsidies through dedicated 100% affordable developments and the Gap Financing Program. Since January 2023, the City has provided $222.7 million to fund 16 affordable housing projects that will produce 1,639 below-market-rate units. The inclusionary path focuses on homes for the local workforce and every day, mixed-income communities. Currently, approximately 20% of moderate- or middle-income households are housing cost-burdened.

Affordability Period for Rental Inclusionary Units (San José Municipal Code § 5.08.600)

Reducing the rental affordability term from 99 years to 55 years for inclusionary rental units will align local covenants with prevailing state standards and financing practice and recognizes the inherit caps on the useful life of the built environment.

- **State Density Bonus Law:** Requires affordable rental units created under State Density Bonus Law to be restricted by a recorded covenant for at least 55 years.

- **California Tax Credit Allocation Committee:** California's tax-credit program applies a 55-year affordability term through the California Qualified Allocation Plan regulation.

- **Low-Income Housing Tax Credit:** Federal law generally ensures at least 30 years of affordability (15-year compliance and an additional 15-year extended use); California extends further to 55 years via state policy.

Aligning locally to 55 years matches what most lenders, investors, and compliance monitors already underwrite, as 99-year restrictions have no beneficial policy gains.

This proposal realigns with state-anchored terms, reduces redundancy, and improves administrability. Additionally, in 2024, Assembly Bill 243 prohibited jurisdictions from charging recurring monitoring fees on 100% affordable State Density Bonus Law projects already monitored under state regulatory agreements, such as agreements under California Tax Credit Allocation Committee, California Department of Housing and Community Development, and California Debt Limit Allocation Committee. When state programs conclude at year 55, continuing separate local monitoring without dedicated funding becomes impractical; aligning to 55 years removes overlap while maintaining long-term affordability.

Surplus Credits Exchange (San José Municipal Code § 5.08.540)

Since 2021, the IHO includes an existing surplus credit system, which allows developments that produce more inclusionary units than required to use those surplus homes into tradeable credits for other projects to meet their IHO obligations. However, no projects have utilized this option due to a lack of a clear regulatory path. The proposed updated ordinance clarifies how credits are created, valued, and applied; preserves equivalency between what is sold and what is bought (e.g., appropriate tenure, bedroom mix, and AMI depth); and provides a predictable, rules-based path to compliance that moves dollars toward actual unit delivery. Enhancements in this update include a focus on equivalency and transferability.

- Clear eligibility criteria for both generating and receiving developments.

- Standardized valuation methodology, providing a transparent process, setting equivalency standards.

- A City-facilitated exchange to connect buyers and sellers and reduce friction, allowing for transferability.

- A 12-month performance review with stakeholder input to assess outcomes and refine rules.

The City will use a room count standard to make sure that housing units are comparable when inclusionary housing credits are transferred between projects. Under this standard, each unit's total number of rooms, including bedrooms and living spaces, should match. For example, a studio counts as one room, a one-bedroom counts as two rooms, a two-bedroom counts as three rooms, and so on.

This approach allows for greater flexibility in exchanging credits between different types of projects, such as those with varying building designs or floor sizes, while ensuring that the overall quality and size of housing units remain consistent. As the program takes effect, the City will continue to monitor compliance and may add new tools or safeguards to encourage credit use and maintain fairness in the process.

The proposed inclusionary credit exchange would create a market in which projects that produce more affordable units than required generate credits, and projects that cannot feasibly meet their full requirement on-site, can purchase those credits to meet their IHO obligations. Figure 3 shows how this would work in practice. Developer B creates surplus affordable units in a high-resource area. Developer A purchases those credits through a City-run exchange to satisfy requirements in a lower-resource area.

Figure 3: Example Transaction in the Inclusionary Credit Exchange.

Expected benefits for establishing the exchange include:

- **For “generating” developers:** The market monetizes surplus production and strengthens feasibility, encouraging mixed-income buildings without additional public subsidy.

- **For “receiving” developers:** It offers a faster, lower-cost compliance path while still requiring a meaningful on-site contribution and producing more housing units.

- **For the City:** It channels private investment into real, deed-restricted homes, increases the likelihood that stalled projects proceed, and creates a transparent, self-funding mechanism subject to periodic review. Conceptually, a project delivering about 10% more affordable units than required could generate multi-million-dollar credit value, improving its own feasibility while enabling another project to move forward - yielding more units overall with no new public subsidy, fostering an ecosystem for abundant housing.

Streamlined Processing for 100% Affordable Developments (San José Municipal Code § 5.08.400)

Projects with 100% affordable units will be allowed to demonstrate their IHO compliance through their state or federal regulatory agreements, rather than going through the typical IHO process and executing an IHO agreement. The terms of the state and federal agreements will be memorialized in an abbreviated City deed-restricted covenant rather than an Inclusionary Housing Agreement, thus removing overlapping obligations while still preserving enforceability and consequences for non-compliance.

The projects, including tax-credit developments, are already subject to rigorous state oversight and carry extensive covenant, monitoring, and reporting requirements. Requiring a parallel City agreement adds time and legal cost without improving outcomes. Projects voluntarily deed-restricting to receive City and state benefits are also subject to legal restrictions. Developers will be required to provide Affordable Housing Development Declaration Forms and record abbreviated Affordability Restriction agreements that will provide legal mechanisms to ensure compliance with affordability restrictions throughout the term of compliance. The anticipated benefits include:

- **Faster delivery**: Cuts processing time that can delay affordable homes by months and eliminates paperwork and time invested by City staff on already-monitored projects;

- **Lower transaction costs**: Reduces duplicative legal drafting, negotiation, and recording costs; and

- **Clear accountability**: Maintains enforceability through existing regulatory covenants and City penalty provisions.

This simpler, non-duplicative compliance path will accelerate 100% affordable housing while keeping strong, enforceable protections in place and are reflected in the Attachment – Revised Regulations for Implementation of the Inclusionary Housing Ordinance.

Administrative Regulation Amendments

While conducting public outreach, the Housing Department received community input from stakeholders. After detailed review and analysis of the proposed recommendations, Housing Department staff has concluded that these additional administrative amendments would streamline the IHO program administration.

1. Streamlining the "First Approval" definition (Section 5.08.185) to exclude preliminary planning activities such as general plan amendments from triggering IHO requirements;

2. Providing flexibility for off-site unit construction timing through the Regulations (Section 5.08.510(C)(6));

3. Removing prescriptive requirements for general public infrastructure improvements from the IHO policy (Section 5.08.590(A));

4. Adding flexibility on minimum contribution requirements from applicants on market and affordable phased developments (Section 5.08.590(C)); and

5. Adding regulatory flexibility for surplus credit utilization timing (Section 5.08.540(D)).

EVALUATION AND FOLLOW-UP

The Housing Department will evaluate program performance based on the following criteria:

- Projects Permitted: Number of projects that achieved building permits under the new provisions.

- Units by Income Tier: Affordable units produced at each AMI level (and tenure, where applicable).

- Surplus Credit Activity: Number of surplus credit transactions completed, and the associated units generated.

- Program Refinements: Data-driven recommendations for clarifying, calibrating, or strengthening the program based on observed performance.

This evaluation will guide any targeted updates needed to improve clarity, predictability, and production outcomes.

COORDINATION

This memorandum was coordinated with the City Attorney's Office, the City Manager's Budget Office, and the Planning, Building and Code Enforcement Department.

PUBLIC OUTREACH

This memorandum will be posted on the City Council Agenda website for the January 27, 2026, City Council meeting. In mid-August 2025, the Housing Department solicited feedback on the revised Inclusionary Housing regulations from 19 development professionals who use the program, including multifamily developers and single-family home builders. The Housing Department has also held two virtual public outreach sessions on October 9, 2025, and December 10, 2025, as well as an in-person community meeting on January 14, 2026, to review the proposed IHO revisions. The Housing Department Director presented and answered questions from attendees, including staff and members of advocacy groups, and neighborhood leaders. A recording of the sessions is available on the Housing Department's website.[1]

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-008, General Procedure and Policy Making resulting in no changes to the physical environment.

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[1] https://www.sanjoseca.gov/your-government/departments-offices/housing/developers/proposed-changes-to-inclusionary-housing-ordinance

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy as defined in section 53083 or 53083.1 of the California Government Code or the City's Open Government Resolution.

/s/
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Director, Housing Department

For questions, please contact Banu San, Deputy Director, Housing Department, at Banu.San@sanjoseca.gov or (408) 975-4489.

ATTACHMENT
Revised Regulations for Implementation of the Inclusionary Housing Ordinance