



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Nanci Klein  
Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** August 6, 2020

Approved	Date
/s/ Kim Welsh	8/7/2020

**SUBJECT: DOWNTOWN RESIDENTIAL HIGH-RISE INCLUSIONARY HOUSING ORDINANCE IN LIEU FEE REDUCTION**

**RECOMMENDATION**

- (a) Adopt a resolution authorizing a reduction in the in lieu fee for Downtown High-Rise (Rental and For-Sale) projects 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 nonresidential uses where the highest occupied floor has a floor level elevation that is at least 150 feet above street level under the Inclusionary Housing Ordinance to the amount of:
  - (i) \$0 for projects obtaining building permits by June 30, 2023, with annual increases to the in lieu fee, for projects obtaining building permits after that date (not to exceed \$13/SF by June 30, 2024 and then \$23/SF by June 30, 2025) and returning the Downtown High-Rise in lieu fee to the full amount for project that receive building permits after June 30, 2025; and
  - (ii) The projects would need to obtain Certificates of Occupancy for 80% of dwelling units on or prior to June 30, 2025.
- (b) Adopt a resolution amending the 2020-2021 Schedule of Fees and Charges (Resolution No. 72737, as amended) to reduce the Inclusionary In Lieu Fee under San José Municipal Code Chapter 5.08 to reflect the schedule in the resolution above for qualifying Downtown High-Rise Residential Developments receiving Certificates of Occupancy for 80% of dwelling units by June 30, 2025.

**OUTCOME**

Approval of the resolutions will result in setting the Downtown Residential High-Rise Inclusionary Housing Ordinance (IHO) as directed by the City Council on November 5, 2019. Under the Inclusionary Housing Ordinance, the in lieu fee for downtown high-rises will be set to \$0 and gradually increase to the full fee amount over a five-year period, encouraging qualified high-rise residential housing developments located in the Downtown to move forward with development.

## **BACKGROUND**

On November 5, 2019, the City Council took the following actions related to Downtown High-Rise development:

- 1) Accepted the report on the Downtown High-Rise Feasibility Assessment.
- 2) Adopted a resolution extending the certificate of occupancy deadline for the AHIF transition period to December 31, 2023 and directed staff to modify that AHIF resolution deadline to match the timeline of the IHO (June 30, 2025).
- 3) Approved an ordinance creating a temporary fifty percent (50%) reduction of the Building and Structure Construction Tax and a fifty percent (50%) reduction of the Commercial- Residential-Mobilehome Park Building Tax for qualified residential high rise projects located within the Downtown Planned Growth Area that obtain a City certificate of occupancy on, or prior to, December 31, 2023 and directed staff to modify the deadline to match the timeline of the IHO (June 30, 2025).
- 4) Directed staff to return to Council with the appropriate resolutions to establish an in lieu fee for Downtown High-Rise (Rental and For-Sale) under IHO in the amount of \$0, with annual increases to that in lieu fee, returning the Downtown High-Rise In lieu fee to the full amount by June 30, 2025 and to amend the schedule of fees and charges accordingly.

Items 1-3 were completed on November 5, 2019 and require no further Council action. City staff is returning now with the resolutions to implement item 4 as directed by City Council.

The San José City Council first approved incentives for high-rise residential development in 2007 with further iterations of an incentive program approved in 2012 and again in 2016. The latest iteration expired in 2018. On June 26, 2018, the City Council adopted resolutions reducing the Inclusionary Housing Ordinance In Lieu Fee to \$0 for rental Downtown High-Rise projects obtaining certificates of occupancy by June 30, 2021. A summary of the other action items related to the program in 2019 is listed in Table A:

**Table A: Summary of Previous City Council Action Items in 2019**

Date	City Council Action Items
<a href="#">June 25, 2019</a>	<ul style="list-style-type: none"> <li>• Approved amendments to the municipal code to require workforce standards for private development projects receiving a subsidy</li> <li>• Directed staff to move forward with a unique services agreement for a consultant to perform the required financial feasibility assessment of Downtown high-rise residential development, with the intent of staff returning to City Council with an extension and amendments to the Downtown Residential High-Rise Incentive.</li> </ul>
<a href="#">September 24, 2019</a>	<ul style="list-style-type: none"> <li>• Considered a report by Strategic Economics “Financial Feasibility of Downtown High-Rise Projects and Potential Impact of Incentives and Workforce Standards”</li> <li>• Directed staff to return to Council with the appropriate ordinance and resolution to enact the AHIF exemption and construction tax reduction for Downtown High-Rise residential development.</li> <li>• AHIF exemption is applicable to projects that were previously approved under AHIF that includes nearly all existing high-rise entitlements. All other projects are subject to IHO with one new high-rise development approved in November of 2019 subject to IHO.</li> </ul>

***Parks Fees***

Prior iterations of the Downtown Residential High-Rise Incentive included reductions in Parks Fees. However, on [December 19, 2017](#), the City Council adopted a new Downtown Core High-Rise Fee Category for Parks, Recreation, and Neighborhood Services, reflecting lower observed occupancy of existing high-rises in Downtown San José. Prior to this new category, high-rise developments paid the same rate as any project with 5 or more residential units. With this new permanent fee category in place, a reduction in Parks Fees is no longer included in the Downtown High-Rise Incentive.

**ANALYSIS**

On November 5, 2019, City Council approved a graduated increase to the in lieu fee for downtown high-rises under the Inclusionary Housing Ordinance (Memorandum can be found [here](#)). The following Table B is a scaled phasing over the coming five years for the In Lieu Fee for Downtown High-Rise developments.

The Inclusionary Housing Ordinance authorizes the City Council to adopt a resolution that reduces the in lieu fees for high-rise developments in a specific area based on findings. The findings to support this reduction include the following:

*“Envision San José 2040 General Plan identifies high-rise residential development in Downtown as playing a major role in the long-range revitalization of the Downtown area as the cultural and recreational hub for the City’s arts, entertainment, and sporting activities. Downtown San José contributes towards the positive identity of the City to the region, the nation, and abroad, and is the only location in the South Bay that actively promotes high-rise development.”*

**Table B: Scaled Phasing Over the Coming Five Years**

<b>Proposed Time Period</b>	<b>In Lieu Fee for Downtown High-Rises (Rental &amp; Fo-Sale)</b>
Building permit by June 30, 2021	\$0/SF
Building permit by June 30, 2022	\$0/SF
Building permit by June 30, 2023	\$0/SF
Building permit by June 30, 2024	\$13/SF
Building permit by June 30, 2025	\$23/SF
Building permit after June 30, 2025	Rental: \$43/SF; For-Sale: \$25/SF
<i>Certificate of Occupancy for 80% of dwelling units must be obtained on or by June 30, 2025 for discounted In Lieu Fee rate</i>	

Strategic Economics developed a static pro forma model to complete the feasibility study required under Title 14 of the Municipal Code. The financial feasibility study demonstrated the difficult development conditions in Downtown for high-rise development. This study and further analysis were presented to the City Council on September 24, 2019. The report is attached linked [here](#).<sup>1</sup>

As was noted at the time, the analysis concluded that a fee/tax reduction would not be sufficient to ensure that projects are financially feasible alone. However, as stated in the analysis,

*“Although the analysis found the prototype to be infeasible, some projects may have unique circumstances that influence development feasibility. This includes projects where the land was acquired at a reduced price. Specific financing arrangements, such as those utilizing the EB-5 and Opportunity Zone programs, may also help improve project feasibility.”*

Given that construction costs continued to rise subsequent to this analysis, along with the severe economic impact of COVID-19, there is no reason to believe that feasibility has improved since this study was conducted. Staff recommends adoption of these previously approved changes until

<sup>1</sup> <https://sanjose.legistar.com/View.ashx?M=F&ID=7709216&GUID=FD432D68-4153-46A9-BFE7-60EAF887660F>

further analysis can be conducted in the future to understand how to enable the continued creation of housing.

Currently, one project, Garden Gate Tower, is requesting to be considered a Downtown High-Rise under the IHO. The project application was previously entitled with two site options (290 residential units or 793 co-living bedrooms) and had selected the in lieu fee to satisfy their IHO obligation. Recently, the applicant submitted an amendment planning application to allow building 336 residential units. This project has not had a public hearing pursuant to California Government Code Section 53083. Please see **Attachment A** for all Downtown High-Rise projects currently in the pipeline.

The findings above and the findings in the conclusion support this limited term reduction in the Inclusionary Housing Ordinance In Lieu Fee.

## **CONCLUSION**

The City desires to encourage high-rise development that will add new housing units, attract additional employers, and increase transit use. While City fees are not the sole reason for development infeasibility in the Downtown area, they are a contributing factor. There is a significant public benefit to increasing the availability of housing and achieving a critical mass of residents in Downtown San José. In addition to contributing to the vibrancy and economic success of the area, new high-rise developments will deliver much needed residential capacity consistent with the goals and objectives of the City's Housing Crisis Workplan. This action will encourage Downtown High-Rise residential developments to move forward.

## **EVALUATION AND FOLLOW-UP**

As part of the Inclusionary Housing Ordinance implementation process, residential developments are required to submit an Affordable Housing Compliance Plan application and obtain approval before scheduling a public hearing for entitlement. Prior to issuance of a building permit, the Housing Department coordinates with the developer to record an Inclusionary Housing Agreement, specifying which fees and or requirements apply to the development. The IHO In Lieu Fees may be paid at any time after the Inclusionary Housing Agreement has been recorded, but prior to issuing a Certificate of Occupancy.

As a condition of the fee reduction, the developer/owner shall provide information requested by City staff for compliance with Government Code Section 53083, and City Resolution No. 77135 for public disclosure of subsidies and any required hearing shall have been held.

## **CLIMATE SMART SAN JOSÉ**

The recommendation in this memo aligns with one or more Climate Smart San José energy, water, or mobility goals.

## **POLICY ALTERNATIVES**

### ***Extension***

Any recommendation to extend the fee reduction beyond the deadlines considered at the November 5, 2019 City Council meeting would require an updated feasibility analysis otherwise the reduction could be considered a subsidy under Chapter 14.10 of the San José Municipal Code. This means projects would be subject to workforce standards, including prevailing wage requirements.

### ***High-rise development outside Downtown***

All previous iterations of the Downtown Residential High-Rise Incentive have only applied to projects in the Downtown. However, there has been some interest more recently in high-rise development outside of Downtown. The feasibility analysis conducted only assessed the feasibility of high-rise development in the Downtown. Any fee reduction for high-rise development outside of Downtown could be considered a subsidy without additional analysis.

### ***COVID-19***

Staff considered an extension related to the impacts of COVID-19 as was applied to the AHIF Transition deadline. However, an extension related to COVID-19, without an additional feasibility analysis, would need to be closely tied to the current local emergency. Since the fee reduction runs until June 30, 2025 there is still time for projects to meet the deadline, and time to consider further changes in the future prior to expiration of the fee reduction.

## **PUBLIC OUTREACH**

The Housing Department and Office of Economic Development hosted an outreach meeting on July 23, 2020 for the development community to provide information and obtain feedback for this memorandum.

This report will be made available to the public on August 7, 2020 through the Housing Department's website, on the City of San José website, and in hard copy in the City Clerk's office, prior to the August 18, 2020 City Council meeting.

## **COORDINATION**

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

**COMMISSION RECOMMENDATION/INPUT**

This item was not heard by the Housing and Community Development Commission, as setting fees for the Inclusionary Housing Ordinance program does not fall under the functions, powers and duties of the Commission delineated in Section 2.08.2840 of the San José Municipal Code.

**COST SUMMARY/IMPLICATIONS**

This memorandum will not include any revenues that would otherwise have been generated by Downtown High-Rise rentals projects that have been exempted from the Affordable Housing Impact Fee and Inclusionary Housing Ordinance and these revenues were not included in the current Affordable Housing Investment Plan and its expenditure.

Due to the incentive being based on time rather than a specific development limit, the potential fiscal impacts of the program will not be fully understood until development applications are received. The Inclusionary Housing Ordinance In Lieu Fee is currently \$125,000 per rental unit and \$157, 858 per For-Sale unit (FY20-21).

Although these changes would result in less fees collected on the Downtown High-Rise developments that do not reach the original deadline, of June 30, 2021, these fees are already considered foregone and are not included in budget projections or in the Five-Year Affordable Housing Investment Plan.

**CEQA**

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

/s/  
NANCI KLEIN  
Director,  
Office of Economic Development

/s/  
JACKY MORALES-FERRAND  
Director,  
Housing Department

For questions, please contact Chris Burton, Economic Development, at (408) 535-8114, or Rachel VanderVeen, Housing, (408) 535-8231.

**ATTACHMENT:**

**Attachment A:** Current Residential Downtown High-Rise Projects

**Attachment A**

**Current Residential Downtown High-Rise Projects**

	<b>Project Name</b>	<b>Project Address</b>	<b>Developer</b>	<b>Number of Units</b>	<b>Square Footage</b>	<b>Status</b>
<b>Affordable Housing Impact Fee</b>						
1	<b>The Graduate (Amcal Housing)</b>	80 E San Carlos	AMCAL Housing	260	261,436	Under Construction
2	<b>Miro (SJSC Towers)</b>	193 E Santa Clara St	Bay View Development	630	587,728	Under Construction
3	<b>Aviato</b>	199 Bassett Ave	StarCity	803	266,593	Entitled
4	<b>Greyhound</b>	70 S. Almaden Ave	Fulton Street Ventures	708	705,420	Entitled
5	<b>Gateway Towers</b>	455 S First St	The Core Companies	220	235,305	Entitled - Convert to Affordable
6	<b>Post &amp; San Pedro</b>	171 Post St	Simeon Properties	228	179,067	Entitled - Added Units
7	<b>27 West</b>	27 S 1st St	Alterra Worldwide	374	273,056	Entitled
8	<b>The Carlyle</b>	65 Notre Dame Ave	Insight Realty	290	191,915	Entitled
9	<b>4th Street Metro Station</b>	439 S 4th St	Caruso Designs	218	197,669	Not Entitled - Ellis Act
<b>Inclusionary Housing Ordinance</b>						
1	<b>Garden Gate</b>	600 S. 1st St	KT Urban	336	273,720	Amendment Process
			<b>TOTAL</b>	<b>4,067</b>	<b>3,171,909</b>	