



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: February 22, 2021

Approved

Date

02/23/21

SUPPLEMENTAL

SUBJECT: ACTIONS RELATED TO THE AMENDMENT OF THE INCLUSIONARY HOUSING ORDINANCE

REASON FOR SUPPLEMENTAL

The reason for this supplemental memorandum is to provide clarity on the net square footage to be charged for the in-lieu fees, clarification regarding the mixed compliance option, updated data regarding neighboring jurisdiction in-lieu fees, an update on the upcoming Cost of Development study and a review of the data presented in the prior Cost of Development Study.

ANALYSIS

Staff continued holding discussions with stakeholders regarding the proposed changes to the Inclusionary Housing Ordinance (Ordinance). These discussions have raised questions requiring clarification to staff recommendations. This supplemental memorandum provides clarity for several issues.

Applying the In-lieu Fee on a Square Footage Basis

The in-lieu fee is applied based on the net square footage of the proposed development. The application of the in-lieu fees proposed in the Ordinance is based on how the Affordable Housing Impact Fee is assessed, which was implemented in 2015. The Guidelines will be updated following the approval of the amended Ordinance. The following provides clarification on what square footage will be excluded in the assessment of the in-lieu fee.

Condominiums and Conventional Apartments

The in-lieu fee will be assessed on net residential square feet of the building area. Measurement shall be from the outside surface of the exterior stud walls and will include all finished living space. The in-lieu fee will not be assessed on the following (exclusions):

1. Vehicular (automobile, motorcycle, bicycle) parking areas, whether assigned to specific units or not, that are separate areas from the residential unit
2. Common hallways that access the front doors of two or more units
3. Common rooms/lounges together with supporting facilities such as kitchens and restrooms
4. Building lobbies
5. Balconies, whether private or open to all residents
6. Common stairwells that serve two or more units
7. Elevator shafts
8. Utility shafts
9. Custodial or janitorial closets
10. Common recreation areas – such as fitness centers, community rooms, and roof spaces
11. Storage lockers not located within residential units
12. Other qualifying areas that are not associated with residential units, upon approval of the Director of Housing

Townhomes and single-family homes will be the measurements from the outside surface of the exterior stud walls, including all finished living space and common areas inside the single-family units. It does not include unheated areas such as parking areas and balconies.

Co-living Type Housing

With respect to developments designed or permitted based on shared common facilities (e.g., co-living, single room occupancy, suite-style student or senior housing) the square footage to be assessed shall be determined in a manner that reasonably reflects the design of a project for separate rental of bedrooms or suites with shared common facilities. For those developments, the exclusions to square footage assessment stated above will not include community rooms, common rooms/lounges together with supporting facilities such as kitchens and restrooms and other heated interior residential areas associated with the dwelling units or suites.

Mixed Compliance Options

To encourage affordable housing production, a new mixed compliance option was added to the amended Ordinance. Developments can choose a mixed compliance option under the proposed changes to the Inclusionary Housing Ordinance. The in-lieu fees are adjusted when projects build affordable units on-site. The fees are further adjusted when different affordability levels are selected for either strong or moderate market areas. **Table 1** represents possible mixed compliance for when projects choose either to building 5% on-site or a combination of 10% on-site with variation of Area Median Income (AMI) levels.

Table 1: Mixed Compliance Option In-lieu Fee Rate

In-Lieu Fee for Rental Residential Developments Providing at least 5% Inclusionary Units On-Site Per Net New Residential Square Footage in Residential Development					
		Adding 20 or More Units or 10 to 19 Units at less than 90% of General Plan density		Adding 10 to 19 Units at 90% or more of General Plan density	
	Inclusionary Units On-Site	Strong Market Areas	Moderate Market Areas	Strong Market Areas	Moderate Market Areas
With 5% Inclusionary Units On-Site	5% at 100% AMI rents	\$18.70	\$11.87	\$9.35	\$5.94
	5% at 60% AMI rents	\$12.47	\$7.92	\$6.24	\$3.96
	5% at 50% AMI rents	\$10.07	\$6.39	\$5.04	\$3.20
With 10% Inclusionary Units On-Site	5% at 100% AMI and 5% at 60% AMI rents	\$10.55	\$6.70	\$5.28	\$3.35
	5% at 100% AMI and 5% at 50% AMI rents	\$8.15	\$5.17	\$4.08	\$2.59
	5% at 60% AMI and 5% at 50% AMI rents	\$1.92	\$1.22	\$0.96	\$0.61
	10% at 30% AMI rents	\$0.00	\$0.00	\$0.00	\$0.00

During the public outreach process, a concern was raised that these mixed compliance option fees should only be applied to the square footage of the entire building, when a portion of those units will be affordable. The underlying methodology takes into account the affordable units, however, in order to simplify the fee and to make it consistent with other development fee applications, the fee is applied to all square footage. There is a continued concern among developers that this methodology does not sufficiently recognize the affordable units. In order to address this concern, an adjustment to the proposed mixed compliance fee structure can be made so that it the in-lieu fee is only applied to the remaining square footage of only market-rate units within a development. In this case, the proposed fee would adjust to \$19.68 per square foot if a developer selects the 5% at 100% of the AMI onsite option. Please note, to make this alternative effective, the Ordinance language and the Schedule of Fees and Charges must be amended.

Table 2 is an alternative fee schedule that would apply if this change in methodology is adopted.

Table 2: Alternative Fee Schedule for Application of Mixed Compliance Fee to the Square Footage of Only Market-Rate Units					
Alternative In-Lieu Fee Schedule if Fees are Applied to Market Rate Units Only Rental Residential Developments <u>Providing at Least 5% Inclusionary Units On-Site</u> Per Net New Residential Square Footage of Market Rate Units in Residential Development					
		Adding 20 or More Units or 10 to 19 Units at less than 90% of General Plan density		Adding 10 to 19 Units at 90% or more of General Plan density	
	Inclusionary Units On-Site	Strong Market Areas	Moderate Market Areas	Strong Market Areas	Moderate Market Areas
With 5% Inclusionary Units On- Site	5% at 100% AMI rents	\$19.68	\$12.49	\$9.84	\$6.25
	5% at 60% AMI rents	\$13.13	\$8.34	\$6.57	\$4.17
	5% at 50% AMI rents	\$10.60	\$6.73	\$5.30	\$3.37
With 10% Inclusionary Units On- Site	5% at 100% AMI and 5% at 60% AMI rents	\$11.72	\$7.44	\$5.86	\$3.72
	5% at 100% AMI and 5% at 50% AMI rents	\$9.06	\$5.74	\$4.53	\$2.87
	5% at 60% AMI and 5% at 50% AMI rents	\$2.13	\$1.36	\$1.07	\$0.68
	10% at 30% AMI rents	\$0.00	\$0.00	\$0.00	\$0.00

Updated In-Lieu Fee Information for Neighboring Jurisdictions

Staff updated in-lieu fee information for neighboring jurisdictions within Santa Clara County. The numbers bolded and shaded in **Table 3** reflects updated in-lieu fees.

Table 3: Neighboring Jurisdiction Current In-lieu Fees			
City	Multifamily (Sq. Ft.)	Condo (Sq. Ft.)	Term (Years)
Cupertino	\$20.29	\$30.75	99
Milpitas	\$35.15	\$35.13	55
Santa Clara	\$20.00	\$25.00	55
Sunnyvale	\$26.00	N/A	55
San José Current	~\$28.00	~\$27.00	55
Average of Cities Above	\$25.89	\$29.47	55

Partnership for Clustered Units Compliance Option

Under the clustered units compliance option projects may choose to cluster by building an 100% affordable housing development immediately adjacent parcel and within close proximity to the market rate building. One of the criteria for this option requires a minimum contribution from the market rate developer to the affordable developer equivalent to 75% of the required in lieu fee. Staff will update the Inclusionary Housing Ordinance Guidelines to provide guidance on how market rate developers may meet their 75% obligation under the clustered units compliance option through contributions such as land value, construction of parking and development of offsite improvements all of which benefiting the affordable housing development.

Future Analysis – Updated Report on the Cost of Residential Development

It continues is important to understand the underlying factors influencing the residential market in San José and the impact of city impact fees and taxes, including the Inclusionary Housing Ordinance. As a part of the Housing Crisis Workplan, the City has conducted two iterations of the *Report on the Cost of Residential Development* (report), with the last report produced in 2019. An update to this report is planned for 2021 as a continued work item within the Housing Crisis Workplan. The Office of Economic Development will be conducting a Request for Proposals to select an outside consultant to conduct the study. As a part of this upcoming report, the City Council has previously directed staff to explore options for extending the timeline of the Downtown Residential High-rise Program and applying it to high-rise development outside of Downtown. This planned report will also allow the City to better understand how the market is recovering from the COVID-19 pandemic, along with other market factors and city impact fees and taxes. There will be an opportunity to review the impact of the Inclusionary Housing Ordinance amendments on the development of new housing as well. This work will be completed before the end of the calendar year.

Prior Cost of Development Study

On November 5, 2019, the City Council discussed the Cost of Development Study for Residential Rental Housing prepared by Keyser Marston. The full study may be reviewed at this link: <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4200129&GUID=5E04A82B-8D9D-46D1-9FFD-5B80A82B565E&Options=&Search=>This report estimated average rents based on asking rents of apartment projects built and completed prior to fall 2019. For purposes of the pro forma analysis, the estimated average apartment rent ranges from \$2,900 to \$3,550 per month depending on the submarket. The average rent is net of concessions, such as a month of free rent offered at lease signing.

Submarket	Monthly Rent Per Unit	Rent Per Square Foot
South and East	\$2,900	\$3.22
Central San José	\$3,300	\$3.67
West San José (Stevens Creek)	\$3,550	\$3.94
North San José	\$3,300	\$3.67
Downtown	\$3,400	\$3.78

These rents were used as the basis to estimate the gap between market and affordable rents for the Inclusionary Housing Ordinance development. Using these rents, it is estimated that the cost to a developer who selects the Mixed Compliance Option of providing 5% of the units at 100% of the AMI and paying the \$18.70 per square foot fee as a total cost of \$25 per square foot. This is lower than the current the cost IHO fee which is estimated to be \$27 per square foot. This cost estimate may increase as market rents increase for a proposed development or it may decrease as current market rent levels are not able to achieve these rents. It should be noted, that rents were not at \$4.00 a square foot during the height of the last market cycle.

COORDINATION

This supplemental memorandum was coordinated with the Office of Economic Development and the City Attorney's Office.

/s/
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Director, Housing Department

For questions, please contact Rachel VanderVeen, Deputy Director, at (408) 535-8231.