



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Nanci Klein
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**SUBJECT: BARRIERS TO AFFORDABLE
HOUSING CONSTRUCTION**

DATE: February 22, 2022

Approved

Date

02/24/22

RECOMMENDATION

Accept the report on barriers to affordable housing construction, and approve the following:

- (a) Add the following work items to the Housing Crisis Work Plan to further assist affordable housing development based on the feedback received during outreach:
 - (1) Create an impact fee registry.
 - (2) Establish internal coordination meetings to help facilitate key deadlines for affordable developments.
 - (3) Evaluate the City's bond issuance and monitoring fees and consider strategies to eliminate the incentive to use outside bond issuers and encourage participation in the City's bond program.

- (b) Explore a new temporary suspension, and clarification of existing exemptions, for the collection of the residential construction taxes listed below for affordable housing development:
 - (1) Building and Structure Construction Tax;
 - (2) Commercial-Residential Mobilehome Park Building Tax;
 - (3) Residential Construction Tax; and
 - (4) Construction Portion of the Construction and Conveyance Tax.

OUTCOME

The report provides an overview of outreach conducted to affordable housing developers and summarizes governmental and non-governmental barriers described by developers during that process. From these identified barriers, staff is proposing to add several items to the Housing Crisis Work Plan along with consideration of suspension of residential construction taxes for affordable housing. If the Council approves the recommendation to explore changes to the construction taxes for affordable housing, staff will return to the City Council for additional action in the spring, as appropriate, based on further analysis.

BACKGROUND

At the August 10, 2021 City Council meeting, as a part of the update on the Housing Crisis Work Plan, the Council directed City staff, in coordination with the Mayor's Office, to identify and communicate with affordable and market-rate housing developers who currently have entitlements but have not received a building permit or occupancy permit. The Council further directed staff to emphasize its outreach to affordable housing developers. Staff was directed to return to the City Council with a report containing the results of the outreach effort.

In September and October of 2021, City staff from the Housing Catalyst Team, along with the Mayor's Office, met individually with seven affordable housing developers who currently had approved or under construction affordable housing projects in San José to discuss the barriers each faced while moving their project forward to construction. Staff will be conducting additional outreach to the development community regarding barriers to construction as part of the update to the Housing Element. This additional outreach will include market-rate and affordable developers, and will further serve as an opportunity to understand the barriers to housing construction.

ANALYSIS

The individual interviews of the affordable housing developers within San José provided an opportunity to have a thorough dialogue about governmental and non-governmental processes that impact the timeline of new affordable housing development. Some key themes emerged from these discussions, as outlined further below. However, overall there is not necessarily one single issue or theme that is preventing approved affordable housing from moving towards construction. Many of those interviewed as a part of this process also noted that they recognized San José's efforts to make improvements and help assist in the production of affordable housing through its allowable densities and work to implement Senate Bill 35 (2017) and Assembly Bill 2162 (2018) that provide for streamlined approval of affordable housing projects.

As staff has highlighted in previous updates on the Housing Crisis Work Plan, the continued rise in the cost of construction has had a dramatic impact on housing development, including affordable housing. The increased costs for affordable housing have meant that developments may need to rely on additional sources of funding to complete a project. In addition, the competitiveness in obtaining funding, especially for the vital Low-Income Housing Tax-Credit financing, has made it even more challenging. Developments have had to apply multiple times to receive a Low-Income Housing Tax-Credit award delaying the ability to start construction from six months to over two years for two developments. Staff has advocated for change in the California Debt Limit Allocation Committee program guidelines to better position affordable housing developments in San José for future allocations of tax-exempt bonds and tax credits. Changes are expected in the coming year and will be tracked to measure the overall impact on proposed affordable housing developments from the Bay Area region.

The discussion and feedback received is summarized below and divided into key categories. Along with the discussion of the topics raised is also an analysis and discussion from staff with potential strategies identified to address the issues. Where appropriate, staff is also recommending certain actions items listed below to be added to the Housing Crisis Work Plan.

Permitting Process

- Dedicated Planner for Affordable Housing – Many of the developers interviewed cited the assignment of dedicated planning staff as being instrumental in their entitlement process. Since 2018, a grant from Destination: Home SV has funded a dedicated Planner position in the Planning, Building and Code Enforcement (PBCE) Department overseeing affordable housing entitlements. During the initial grant period, from September 1, 2018 through June 30, 2021, planning staff reviewed 14 extremely low income and supportive housing proposals, representing 1,270 affordable units. Projects that went through this facilitated process secured approval within nine months on average, compared to 11 months for projects that went through the normal process. The funding also allowed planning staff to more effectively and efficiently guide affordable housing developers through the entitlement process. Based on these results and positive feedback from the development community, Destination: Home SV agreed to another three-year grant covering the period from July 2021 through June 2024.
- Building Permit Process – Several of those interviewed cited the success of the dedicated Planner in helping their projects obtain planning approval and were interested to know if a similar program could be established to assist developers in obtaining construction permits. This generally includes working with the Building Division of PBCE and the Public Works Department.

Work Plan Item: Given the current capacity of the Building Division, it is not possible at the present time to have a facilitator similar to the Destination: Home Planner. However, the Housing Catalyst Team plans to establish regular coordination meetings between the Building Division, Public Works, and the Housing Department to review active projects and understand specific timelines related to the various funding sources for affordable projects. The timing of these meetings could be established as shortly after new funding has been allocated to projects and the associated deadlines are known. Understanding these deadlines earlier in the process will allow staff in development services to work within a schedule that can achieve the required milestones.

Land Use and Design Standards

- Private Open Space Requirements – Private open space (e.g., balcony or patio, etc.) is required for all residential units. However, as some interviewees shared, this requirement is not always compatible with permanent supportive housing. However, this is a standard that can be forgone if a project elects to use a State Density Bonus Law incentive or waiver, and that is what most have done.

- Commercial Space Requirements – Several of those interviewed mentioned commercial space requirements as something that was a challenge in their project. These challenges are often related to financing difficulties as a funding source may restrict what types of tenants can occupy a space or can relate to the ability to find a suitable tenant for the commercial space. In response to this feedback, the City Council in December 2021 removed commercial requirements on 100% affordable housing projects.
- Parking Requirements – Some of those interviewed discussed the City’s parking requirements. Often projects will use Density Bonus Law to reduce parking for their project. They would welcome reductions to or the elimination of parking requirements. They also worry about any added costs that transportation demand management (TDM) provisions might add to the costs of a project. Staff is currently evaluating its parking and TDM standards and anticipates returning to the City Council with recommendations in the summer. The Density Bonus Law will also continue to be an option that projects can utilize to lower their parking requirements.
- Electric Vehicle Charging – Several mentioned that the Building Reach Code requirement to provide electric vehicle charging parking spaces and electric vehicle ready parking spaces add additional costs to a project due to the space and infrastructure necessary. Again, eliminating or reducing parking requirements would partially alleviate this concern.

City Fees and Taxes

- Construction Taxes – In several interviews, construction taxes were mentioned as an added cost on affordable development. There are four taxes charged on the construction of new residential development. These taxes are (1) Building and Structure Construction Tax; (2) Commercial-Residential Mobilehome Park Construction Tax; (3) Residential Construction Tax; and (4) Construction portion of the Construction and Conveyance Tax. The majority of proceeds from these taxes go into capital funding and staffing primarily for transportation and infrastructure, with some also going to public safety and parks capital funding. From 1992 until 2011, residential construction taxes were suspended for very low-income affordable housing. Additionally, staff has become aware that there has remained a suspension/exemption of the Building and Structure Construction Tax and the Commercial-Residential Mobilehome Park Construction Tax in the Municipal Code for certain affordable housing units receiving specific types of federal funding that includes Section 8. These suspension/exemption sections date back to the 1970s, have never been updated and do not contain a sunset clause.

Action Item: Staff recommends to the City Council that further analysis be done in consideration of a new temporary suspension of residential construction taxes for affordable rental housing. While these costs alone are not enough to make or break a project’s ability to move forward, they do represent one lever within the City’s control to lower the cost of new affordable development. In Fiscal Year 2020-2021, there were seven affordable projects issued building permits for 846 housing units that paid a total of

\$2,692,929 in construction taxes. These construction taxes represent an important funding source for City departments, particularly the Department of Transportation, and staff believes it would be prudent to fully understand the implications of any reduction of this funding before moving forward.

FY 2020-2021 Construction Taxes from 100% Affordable Development

Building and Structure	Commercial-Residential Mobilehome Park	Residential Construction	Construction and Conveyance	Total
\$993,157	\$1,560,677	\$75,870	\$63,225	\$2,692,929

If the City Council approves this recommendation, staff will return later this spring with a more complete analysis of the forecasted tax revenue over the next five years along with a recommendation on whether it believes the Council should adopt a new suspension of the taxes. Staff would also analyze and consider whether a partial suspension, e.g., 50% reduction, or a suspension only for homes targeting specific income levels, e.g., extremely-low income, would be more feasible for the City departments while still providing some benefit for affordable projects.

Additionally, more projects are looking to use the existing suspension of the Building and Structure Construction Tax and the Commercial-Residential Mobilehome Park Construction Tax due to receiving project-based Section 8 vouchers. Staff would like to provide clear guidance on the application of this tax suspension through cleanup of the Municipal Code section. The existing code section references outdated funding sources that are no longer used to finance affordable housing. When staff returns with further analysis and recommendations in the spring, it will also bring forward recommendations to address this older code section.

- Park Impact and Park Dedication Impacts Fees – Affordable housing developments currently receive a 50% credit in Park Impact/Parkland Dedication Impact fees for each unit of affordable housing. Those interviewed were appreciative of this reduction and urged the City to keep this discount in place. Some indicated a further discount would be helpful, but also understood the need to fund park development. Staff is not recommending making any changes to this fee at this time.
- Bond Issuance – Multi-family bond issuance is guided by Council Policy 1-16, and the City requires that it be the issuer of all bonds financing multi-family housing rental projects within the City with a few exceptions. Having the City as the issuer of bonds helps to sustain the City’s ability to participate in affordable housing development by providing the City an opportunity to participate in addressing a project if it fails to comply with requirements in the future. The City team works with the developer and other lenders to prepare bond documents and issue the bonds consistent with the timelines outlined by the California Debt Limit Allocation Committee. City issuance also requires a local public hearing of the City Council that provides for greater local transparency and input. However, several of those interviewed expressed an interest in

using outside bond issuers to reduce costs as there are fees for issuance and ongoing compliance monitoring. The City has approved exemptions to the Council Policy thus allowing other entities to issue multi-family housing bonds for several projects in recent years and will continue to consider those exemptions based on the Council Policy and the circumstances of each project.

Work Plan Item: Staff will review the level of service and local transparency provided by other issuers and evaluate and compare bond issuance and monitoring fees from those issuers and compare those costs to the City's fee structure. Based on this information, staff will consider strategies to eliminate the incentive to use outside bond issuers and encourage participation in the City's bond program.

- Fee Estimates/Calculation – Besides the increased cost to development that taxes and impact fees add, some of those interviewed shared that obtaining tax and fee estimates can be challenging.

Work Plan Item: A work item on the City's Roadmap Backlog is the Development Fee Framework. The Development Fee Framework is a set of standards that can be used to guide changes to fees and taxes for multi-family residential construction. The goal of the Framework is for major residential fees and taxes to be aligned around a set of common parameters and for the administration of major development fees and taxes to be simplified. The Framework will also make it easier to provide a project developer with fee and tax calculations and estimations. It will also increase transparency for the public. As an additional work item considering that the Framework is not currently on the City Roadmap, staff will work on developing an impact fee registry that would be a unified place listing all fees and taxes for residential development with a point of contact in the department responsible for providing information and estimates to help better assist the development community.

Other Policy Topics

- Impact on Policy Changes to Site Selection – One topic raised by numerous builders in interviews were challenges around site selection and funding availability. Affordable housing projects take many years to go from acquisition of a property, to planning approval, to applying for funding, to awarding of funding, to construction, and finally to completion. Over the course of this process, policies and priorities can shift, which can then interrupt or stall a project. At the local and state level recently, there have been changes in what locations are prioritized for receiving funding. Many of those interviewed understood and often agree with policy purpose behind these changes. However, these changes can mean that what was a project that would rank highly for funding when the site was acquired now moves to something that may rank lower by the time they are applying for funding and ready to start construction. As policies change during the development process, developers need to reposition the development mid-stream. Changing aspects of the proposed development to ensure competitiveness for

funding may impact the design of the building, which will add time to the development timeline.

Non-Governmental Barriers

- **Construction Costs** – Those interviewed confirmed the continued rise in construction costs through the pandemic. The cost of construction remains a significant barrier to affordable housing. The cost of labor has remained a contributor to the increased cost of construction, but other factors such as the cost of specific materials have added to the increase of overall cost. Additionally, given the continued rise in costs, it can be difficult to manage costs while waiting for funding. Adding the need for additional funding sources further compounds this problem since it can take more time.

Maximizing allowed density is important for the goals of the City in increasing its supply of affordable housing. Some of those interviewed had contemplated reducing density in a project in order to lower costs and become more competitive for funding. Reducing density might put the project in a construction type with lower costs. Staff will continue to monitor this issue.

CONCLUSION

There are numerous factors both governmental and non-governmental that influence the ability of an affordable project to move forward. However, outside of the cost of construction, there are many lesser factors that can contribute to the ability or inability of a project to move forward in the City. Staff is recommending several actions to try to help facilitate affordable housing construction, including exploring a temporary suspension of construction taxes.

EVALUATION AND FOLLOW-UP

Staff will follow up on the work items highlighted in the analysis section and incorporate the work into the Housing Crisis Work Plan. Each item will be tracked and monitored as a part of the regular updates on the Housing Crisis Work Plan to either the Community and Economic Development Committee or the City Council. The next update on the Housing Crisis Work Plan is scheduled for May at the Community and Economic Development Committee with a cross-reference to a City Council meeting. The updating and suspension of residential construction taxes for affordable development will be brought back to the City Council as a separate action item this spring, as appropriate, based on further analysis. Staff will also be conducting additional outreach through the Housing Element update process that will further serve as an opportunity to understand the barriers to affordable and market-rate construction.

CLIMATE SMART SAN JOSE

The recommendation in this memorandum has no effect on Climate Smart San José energy, water, or mobility goals.

PUBLIC OUTREACH

The work completed to provide this report involved individual interviews of affordable housing developers with active projects in the City in October and September. Staff will conduct additional outreach on this topic as a part of the update to the Housing Element that will include outreach to market-rate and affordable developers. This memorandum will be posted on the City’s Council Agenda website for the March 8, 2022 Council Meeting.

COORDINATION

This memorandum was coordinated with the City Attorney’s Office, the Department of Parks, Recreation, and Neighborhood Services, the Department of Transportation, the Finance Department, and the City Manager’s Budget Office.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project. File No. PP17-003. Agreements/Contracts (New or Amended) resulting in no physical changes to the environment and File No. PP17-006. Preliminary direction to staff and eventual action requires approval from decision making body.

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