



Memorandum

TO: COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE

FROM: Chris Burton

SUBJECT: DEVELOPMENT FEE FRAMEWORK STATUS REPORT **DATE:** April 12, 2024

Approved

Date

4/14/24

RECOMMENDATION

Accept a status report on the creation and implementation of the Development Fee Framework, including consideration of the analysis of the Parks Development Impact Fee Study.

SUMMARY AND OUTCOME

Staff resumed work on the Development Fee Framework through the reconvening of the Development Fee Framework Working Group (Working Group). The Working Group will continue to work toward a previously identified objective and goals. The status report outlines work that will culminate in the adoption of a City Council Policy in spring 2025 that will memorialize the Development Fee Framework.

BACKGROUND

In March 2019, the City Council added an item at the Council Priority Setting Session entitled the “Universal Development Fee.” This priority directed staff to explore creating a universal development fee and structure for residential development that contains all current development taxes and impact fees. In November 2019, staff recommended pursuing a Development Fee Framework (Framework) that would align existing major development fees around shared guidelines rather than the development of a new Universal Development Fee. While it is possible that the City could undertake the work of a Universal Development Fee, this would be both a time- and resource-intensive process and present possible legal challenges.

In March 2020, a report to the Community and Economic Development (CED) Committee was scheduled, but the hearing was canceled due to the onset of the COVID-19 pandemic. The planned report was later released as an information memorandum. In February 2021, staff provided an update to the CED Committee on the Framework and hosted a virtual community engagement meeting. At that time, work on the Framework included the adoption of new

geographic areas by the City Council for the Inclusionary Housing Ordinance that would also serve as the geographic areas for the Framework.

Starting in January 2022, a Working Group was convened composed of staff from the Office of Economic Development and Cultural Affairs, the Department of Planning, Building, and Code Enforcement, the Housing Department, the Department of Parks, Recreation and Neighborhood Services, and the Department of Transportation. The Working Group met twice a month until the summer of 2022. This resulted in agreed-upon objectives and goals related to the implementation of the Framework and refined the necessary individual elements of the Framework. These elements are explained further in the analysis section of this memorandum. On June 21, 2022, staff provided a status report to the CED Committee on the Framework.

On June 20, 2023, the City Council adopted the 2023-2031 Housing Element, which includes over 125 strategies and programs envisioned for the entire eight-year period of the Housing Element. That work is intended to facilitate the production and preservation of housing units in the City and facilitate the City's Regional Housing Needs Allocation of 62,200 housing units. The Framework was included as item P-10, *Standardize and Streamline Permitting, Fees, Applications*, in the Housing Element and the current Housing Catalyst Team Work Plan.¹

ANALYSIS

Development Fee Framework Concept

The concept of a Universal Development Fee, which later evolved into the Framework, resulted from the work in the previous Housing Crisis Work Plan, particularly the Report on the Cost of Residential Development. The Cost of Residential Development Reports² give a more holistic view of how the City's fees and taxes influence the feasibility of residential projects. It also brings to light other structural challenges to align City fees under one methodology. The best example of this is having some fees charged per unit, whereas others are charged on a per-square-foot basis.

In the past, fee increases or changes were often considered independently of other fees and taxes, which made it difficult to gauge the true impact of the changes. Developers look at financial feasibility at multiple points in the development process. The earlier that fees and costs can be understood, the easier it is for a developer to account for and plan for anticipated costs and obtain financing. If fees are added or changed (increased or decreased) later in the development process, it can be detrimental to the financial feasibility of a project. The Framework is not proposing to change any fees, or the legally required methodologies related to calculating the fees. The Framework is instead intended to help facilitate housing production by making the costs associated with financing new development more transparent and easier to predict and

¹ Housing Catalyst Team Work Plan: <https://www.sanjoseca.gov/your-government/departments-offices/planning-building-code-enforcement/planning-division/citywide-planning/housing-catalyst>

² Cost of Residential Development Reports: <https://www.sjeconomy.com/how-we-help/programs-and-services/city-of-san-jose-housing-development-initiatives/cost-of-residential-development-report>

understand. The feedback consistently heard from the development community is that certainty, predictability, and clarity are very important. This will also increase transparency and provide clarity for San José residents.

Development and implementation of the Framework is aligned with the direction received by staff through a memorandum from Councilmembers Davis and Jimenez to the Rules and Open Government Committee on November 1, 2023.³ One key item from that direction was for staff to assess the cost implications of the City's regulatory framework and incorporate findings into future Reports on the Cost of Development. Through completion of the work on the Framework contemplated in this report, staff will be able to complete this recommendation.

In 2022, the Working Group agreed upon the following objectives and goals for the implementation of the Framework:

Development Fee Framework Working Group Outcomes	
<i>Objective</i>	Simplify the administration and calculation of major residential development fees and taxes to provide transparency and certainty to the public and development community.
<i>Goal #1</i>	Adoption of a Council Policy to memorialize the Development Fee Framework elements and parameters.
<i>Goal #2</i>	Develop a webpage and other resources that disclose current fee structures and are organized by geography that can be used to estimate City development costs (fees and taxes) quickly and easily.

Following the June 2022 report, Working Group meetings were paused due to staffing changes and the substantial effort to expend time and resources on updating the Housing Element and other high-priority work. Following the adoption of the Housing Element by the City Council in June 2023, work on the Framework was further paused to allow the capacity for staff to complete a third submission of the Housing Element for certification by the state.

Previous Policy Work on Framework

Previous work on the Framework identified four common elements to align how the structure and administration of the major development fees and taxes can be publicly disclosed and easily understood. These elements are the following:

- 1) *Metric of Calculation* – Defining the metric used to assess fees as square feet rather than per unit. This also includes standardizing citywide definitions of square feet.

³ November 1, 2023 Memorandum:

<https://sanjose.legistar.com/View.ashx?M=F&ID=12397041&GUID=4E2A3535-5F88-4773-B6B3-1E5CA87A8D23>

- *Construction Taxes:* While construction taxes related to residential development are included in the Framework, there are some unique challenges with fully integrating them into the Framework. Construction taxes are collected consistently on a citywide basis and are generally based on building valuation. Formal changes to these taxes can require voter approval. Rather than make formal changes to the construction taxes, the goal for construction taxes, as previously discussed by the Working Group, will be to provide accurate estimations that are easy to use and understand.
- 2) *Development Geography* – Defining standardized geographic areas of the City used in the administration of fees. These areas have been defined along with previous work on the Framework concurrently with changes to the Inclusionary Housing Ordinance. These areas will be used in future economic analysis of residential development, i.e., Cost of Residential Development Reports, and in the Council Policy.⁴
- 3) *Timing of Payment* – Aligning the time at which fees are paid to the City. Previous Council direction included shifting the timing of payment to later in the construction process to help lower the expense of the development.
- *Technical Changes Needed:* As previously discussed by the Working Group and in past reports, staff is interested in shifting the timing of payments to the scheduling of the final inspection. A project could not schedule its final inspection until fees have been paid. This places the timing of payment close to the issuance of the Certificate of Occupancy but also makes collection and administration of the fees/taxes easier. However, the current permit system would need to be modified to facilitate this change, as there is no mechanism to prevent scheduling final inspections to ensure that all fees have been paid. Legislation introduced in the current session, Senate Bill (SB) 937, would require all impact fees to be paid no sooner than at Certificate of Occupancy and would disallow collection at final inspection. Given the potential impacts of this legislation, the Working Group will consider a Certificate of Occupancy should this bill continue to move forward in the legislative process.
- 4) *Development Typology* – Each fee program may use different definitions to identify the type of residential development. The Framework will standardize these definitions of building types, e.g., high-rise, etc.

In addition to the above elements of the Framework, there are other items that the Working Group has discussed that staff intends to include in the future Council Policy.

- a) *Guidelines for new fees and/or policies* – A key component of the Council Policy will provide guidance on how staff should consider new fees or policy changes that will impact the cost of residential construction. This guidance could include providing requirements or the steps necessary for staff to complete before proposing a new fee or policy to the City Council that will impact the cost of residential construction. For example, the Council Policy

⁴ <https://csj.maps.arcgis.com/apps/webappviewer/index.html?id=8518bc095ae54f4ea025d7743c650881>

could stipulate that staff should bring forward a third-party fiscal feasibility analysis along with the associated new fee or policy so that staff and the City Council can adequately weigh the trade-offs before making a decision.

- b) *Automatic Fee Increases* – Another component of the policy will be to define a unified index that automatic fee increases should utilize. Given recent experience, staff may also recommend that automatic fee increases tied to an index be capped at an appropriate level to increase predictability in years with high inflation.

These additional elements may expand as work continues on the Framework and associated Council Policy.

Future Work Plan for Framework

In March 2024, staff continued work on the Framework following the completion of the Housing Element Annual Progress Report and an update on the Housing Catalyst Team Work Plan. The Working Group convened in early April 2024 and will meet bi-monthly moving forward, with the Housing Team within Planning, Building and Code Enforcement taking the lead on planning and convening the Working Group.

The staff has initially divided the Work Plan into two phases. The first phase will include the development of a draft Council Policy.

Proposed Work Plan (Phase 1)	
1) Working Group Reestablished with bimonthly meetings	April 2024
2) Working Group develops the initial draft of the Council Policy and establishes the webpage described in Goal #2	May 2024 – October 2024
3) Initial Review of Draft Council Policy and Public Outreach	October 2024 – December 2025
4) Revisions to Council Policy based review and feedback	January 2025 – February 2025
5) Proposed draft Policy Presented to City Council	March 2025

Phase 2 – Framework Implementation for Existing Fees

In addition to the development of the Council Policy, staff has begun to contemplate how to fully implement the elements of the Framework into existing fee programs. This work will follow the adoption of the Council Policy. This implementation work will require additional time and involve making City ordinance changes. This could include the development of a unified municipal code section that contains relevant definitions used by multiple fee programs. In the current structure, many of these definitions live independently within the municipal code and may or may not align with each other which can create confusion or challenges in administration.

Parks Development Fee Study

The CED Committee has heard several reports on the Parks Development Fee Study (Fee Study). These CED Committee meetings are listed on the Fees that Support Parkland Development Department webpage⁵. The last CED Committee report regarding the Fee Study was on November 28, 2022. During that meeting, the idea of a Parks Commercial Impact Fee was also discussed. A Parks Commercial Impact Fee could support funding improvements to existing parks, trails, and community centers, and would ensure non-residential development pays their fair share in the cost to provide these services.

Since the November 2022 CED Committee meeting, a first draft of the Fee Study, which considers the maximum amount of residential and non-residential development parks fees that could be legally considered by the City, was completed and internally circulated to the Working Group. However, further supplemental fiscal analysis to understand feasibility was not completed. Work on the supplemental fiscal analysis was delayed in order to provide staff capacity to update the Housing Element. Additionally, the Fee Study Task Force⁶ (a citizen group that supported staff in the development of the Fee Study) requested more information about how the findings shared with the Task Force could be considered in context to the City's Cost of Residential Development reports.

On October 26, 2023, the City Council held a study session on the Report on the Cost of Residential Development. That report demonstrated the current extremely challenging economic conditions that are stalling new residential construction. This includes high interest rates, high labor costs, and high materials costs.

In March 2024, the Mayor released his March Budget Message that was approved during the March 19, 2024, City Council meeting. The March Budget Message included, "Minimizing fee increases now creates an opportunity to unlock these [housing] projects as interest rates decline and rents rise over time. The City Manager is directed to continue to make every effort to ensure that fee increases are commensurate with cost requirements and explore the potential to pause certain fee increases where feasible and appropriate, including fees related to the inclusionary housing ordinance."

Therefore, the Department of Parks, Recreation and Neighborhood Services has decided to pause additional work related to the Fee Study, which includes pausing any consideration of potential changes to residential development fees and/or new commercial park impact fees. Staff is working with the Office of Economic Development and Cultural Affairs' consultants that prepared the last Cost of Development Study to better understand the implications and feasibility of having the current park fees be considered within the Framework. That analysis is expected in the late spring or summer of 2024.

⁵ Fees that Support Parkland Development: <https://www.sanjoseca.gov/your-government/departments-offices/parks-recreation-neighborhood-services/in-the-works/fees-that-support-parkland-development>

⁶ Fee Study Task Force: <https://www.sanjoseca.gov/your-government/departments-offices/parks-recreation-neighborhood-services/in-the-works/fees-that-support-parkland-development/task-force-meetings-agendas-videos-and-minutes>

EVALUATION AND FOLLOW-UP

Staff will proceed with the proposed work plan for phase 1 as described above. The result of that work plan is intended to be a proposed Council Policy to the City Council in Q1 2025.

COST SUMMARY/IMPLICATIONS

There are no current cost implications for pursuing the described policy approach for the Framework. The Framework itself is not intended to increase or decrease any fee or tax. It is intended to provide more transparency and ease of administration of existing or future fees or taxes for staff, the residential development community, and the public.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, the Department of Parks, Recreation, and Neighborhood Services, the Department of Transportation, and the Housing Department.

PUBLIC OUTREACH

This memorandum will be posted on the Committee's Agenda website for the April 22, 2024, CED committee meeting. Staff intends to conduct outreach later in the fall as described in the proposed work plan for phase 1.

COMMISSION RECOMMENDATION AND INPUT

No commission recommendation or input is associated with this action.

CEQA

Not a Project, File No. PP17-009, Staff Reports, Assessments, Annual Reports, and Informational Memos that involve no approvals of any City action.

PUBLIC SUBSIDY REPORTING

This item does not include a public subsidy.

COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

April 12, 2024

Subject: Development Fee Framework Status Report

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/s/

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