



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jacky Morales-Ferrand

**SUBJECT:** SEE BELOW

**DATE:** May 1, 2018

Approved

Date

5/2/18

**SUBJECT: CLARIFICATIONS REGARDING THE TRANSITION FROM THE  
AFFORDABLE HOUSING IMPACT FEE TO THE INCLUSIONARY  
HOUSING ORDINANCE**

## RECOMMENDATION

- (a) Adopt a resolution that amends Resolution No. 77218 as previously amended by Resolutions No. 78010, 78392 and 78473 (collectively the "Housing Impact Fee Resolution") by updating Section 13 regarding the transition between the Affordable Housing Impact Fee and Inclusionary Housing Ordinance Programs to (a) replace the requirement for issuance of Building Permits with a requirement for submittal of final approved building plans; (b) to add a transition process for rental projects that have not recorded an affordable housing agreement but were eligible for the AHIF Pipeline Exemption; (c) to add a transition process for rental projects with tentative maps approved prior to June 30, 2018; (d) allow Downtown High-Rise projects that fail to obtain Certificates of Occupancy by the applicable due date to pay the housing impact fee rather than meet the inclusionary housing ordinance requirements if they have obtained Building Permits; and (e) clarify that the AHIF continues to apply to projects with less than 20 units; and
- (b) Accept the Housing Department's staff report regarding the transition from the Affordable Housing Impact Fee (AHIF) to the Inclusionary Housing Ordinance (IHO) program for new rental developments in San José.

## OUTCOME

Approval of the recommended actions will provide clarity to the Housing Department, developers, and other stakeholders regarding the transition between the AHIF and IHO programs.

## **BACKGROUND**

### **Inclusionary Housing Ordinance (IHO)**

The Inclusionary Housing Ordinance (IHO), Chapter 5.08 of the San José Municipal Code, was adopted on January 12, 2010. The IHO applies to for-sale and rental market rate developments of 20 or more units. The provisions of the IHO that apply to rental developments were suspended until the court decision in *Palmer v. City of Los Angeles* was superseded. On September 29, 2017, the Governor signed Assembly Bill 1505, clarifying the State Legislature's intent to supersede the court decision in *Palmer v. City of Los Angeles*, thus allowing the IHO requirements to apply to rental residential developments effective January 1, 2018.

The IHO provides several ways that a developer may meet the affordable unit requirement. This includes construction of affordable units that are evenly distributed On-site, where 15% of the On-site units are deed restricted affordable. When a developer selects an alternative compliance option to provide the units Off-site, then the requirement to provide affordable units is increased from 15% to 20%. Similarly, the In-Lieu fee is calculated based on the 20% requirement.

### **Affordable Housing Impact Fee (AHIF)**

On November 18, 2014, the City Council adopted the Affordable Housing Impact Fee (AHIF) Resolution, establishing the AHIF Program. This requires rental developments with 3 or more units to pay an Affordable Housing Impact Fee at Building Permit issuance. The AHIF Program includes a Downtown High-Rise limited-time waiver of the fee for any rental development, which meets all of the following criteria:

- 1) The rental development is located in the Downtown Core Area (as described in Resolution No. 73587 and as shown in **Attachment A** – adopted January 9, 2007);
- 2) The rental development meets minimum height requirements where the highest occupied floor within the project must have a floor level elevation of at least 150 feet above the street level (as verified by plans submitted to the Building Division);
- 3) The developer provides evidence that the development is not a for-sale development;
- 4) The developer, prior to issuance of a Building Permit, records an Housing Impact Fee Agreement, specifying which fee shall apply in the event the developer fails to satisfy all waiver requirements; and
- 5) The developer provides evidence that its final Certificates of Occupancy are ready to issue, except for the fee waiver, on or prior to June 30, 2021.

### **Transition between the AHIF and IHO for Rental Developments**

On December 19, 2017, the City Council adopted resolution 78473 amending the Housing Impact Fee Resolution to provide a framework for a transition process between the AHIF and the IHO programs for all rental developments. The adopted framework explains how the AHIF will apply during the transition period between January 1, 2018 and June 30, 2018. Rental

developments that had already recorded their affordable housing agreements would continue to be subject to the AHIF. Rental projects with first approvals after June 30, 2018 will be subject to the IHO.

In the transition period, the AHIF is available to rental projects that submit an eligible planning application (Conditional Use, Planned Development, Site Development, or Special Use Permit), pay all planning fees, submit an Affordable Housing Compliance Plan, and pay a \$3,200 Housing application fee before June 30, 2018. As an alternative to complying with the IHO, developers of these transition projects may pay the AHIF if they:

- a) complete an IHO transition waiver specifying that if they did not comply they would be subject to the IHO, and
- b) pay the then current AHIF and obtain all Building Permits for the residential development prior to January 31, 2020, or if eligible for the Downtown High-Rise Exemption, record an agreement prior to issuance of the project's Building Permits.

City Council also directed staff to return with an analysis of Municipal Code section 5.08.470. This section of the IHO establishes the standards for affordable units built On-site. In particular, staff was asked to address how rental projects would meet the requirement to locate these On-site "so as to not create a geographic concentration of inclusionary units."

## **ANALYSIS**

This memorandum addresses issues that have arisen during the transition period. Specifically, this memo addresses the following issues: 1) Replacement of Building Permits to satisfy the transition period obligation; and 2) Changes to the Affordable Housing Impact Fee Resolution to address: a transition for rental projects that applied for the AHIF Pipeline exemption but have not been issued Building Permits or recorded an agreement implementing the pipeline requirements; transition projects with Tentative Maps; transition projects that are also Downtown High-Rises; and the continuing application of the AHIF to rental projects with 3-19 units. In addition, this memorandum clarifies the requirements for projects that choose the On-site compliance option under the IHO with respect to geographic concentration.

### **Replacement of Building Permits for Satisfaction of the Transition Period Obligation**

Under the existing AHIF program, a residential development that qualifies for the transition and elects to pay the impact fee, can do so at any time as long as the impact fee is paid prior to Building Permit issuance. For the purposes of this memo, this section only applies to non-Downtown High-Rises residential development projects. See below for a section specifically addressing Downtown High-Rises.

Currently, all of the Building Permits for a rental development (non-Downtown High-Rises) must be issued by January 31, 2020 to meet the AHIF transition program requirements. In the process of reaching out to developers, staff realized that in order to calculate the correct AHIF,

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the project must have final approved building plans that match its entitlement conditions. Once the AHIF is paid, the project's affordable housing obligation is fulfilled. Tracking all residential developments through the Building Permit issuance process and requiring all rental development's Building Permits to be issued by January 31, 2020, was making implementation more complicated.

The implementation challenge is particularly relevant for projects with multiple buildings that are constructed in phases. Phased projects may still take advantage of this change, but must have all final building plans approved by the Building Division of Planning, Building and Code Enforcement (PBCE). Yet phased projects that finalize building plans for just the first phase of the project by the January 31, 2020 deadline will only be able to pay the AHIF on the first phase. If final building plans for the other project phases are not approved by the deadline, then those phases may be subject to the IHO.

This proposed change will allow a residential development in the AHIF transition process to satisfy its requirements by obtaining final approved building plans instead of building permits by the January 31, 2020 deadline. Overall, this would mean more residential development projects are likely to satisfy the requirements for the AHIF transition program. Therefore, less projects will be subject to the IHO. The IHO would provide the City with a higher Inclusionary In-Lieu fee or require developers to select another compliance option, such as providing deed restricted affordable units.

The Housing Department supports the recommended change of requiring final approved building plans instead of all residential building permits because it gives residential development projects more predictability. It also reduces the Housing Department's administrative requirement to track Building Permit issuance after the AHIF is already paid. Additionally, this process provides the Department with much needed affordable housing at an earlier point in time. Funding under the AHIF program will be paid much earlier than under the IHO program. Under the IHO, the In-Lieu fee is not paid until Certificate of Occupancy.

As a result, the Housing Department is now recommending that developers who elect to pay the AHIF prior to January 31, 2020 are not required to have obtained all of their residential building permits by that date, but instead must have final approved building plans from the Building Division and are ready to pay for their residential Building Permits. All other requirements of the transition process will still apply.

### **Changes and Clarifications to the AHIF and IHO Programs and Transition Process**

In this section there are three proposed changes to the transition process to provide separate procedures for special types of projects that cannot be addressed under the existing transition process and one clarification that the smaller 3-19 unit projects remain subject to the AHIF.

*AHIF Pipeline Exemption Projects*

A proposed new subsection will be added to Section 13 of the AHIF resolution to provide a modified transition process for the Pipeline Projects that do not have recorded agreements.

The original AHIF resolution provided a limited grandfathering provision (Pipeline Exemption) open to projects with approvals completed before June 30, 2016. At that time, twenty-eight developments were deemed eligible for the exemption. A development that applied for the Pipeline Exemption and met all the criteria would obtain a waiver of the AHIF if the development received its Certificate of Occupancy for buildings containing at least 50% of the declared units prior to January 31, 2020.

As part of the Pipeline Exemption requirements, these eligible projects were required to record a pipeline exemption agreement prior to Building Permit issuance. So far only twenty-one developments have recorded their agreements and been issued permits. Two of the original twenty-eight projects dropped out of the Pipeline Exemption process. Two more projects remain in the Pipeline Exemption process which do not have recorded pipeline exemption agreements or Building Permits. These two projects may still record a pipeline agreement but must meet the Certificate of Occupancy deadline noted above. The revisions to the resolution will allow these delayed pipeline applicants to stay under the Pipeline Exemption. If these two Pipeline Exemption projects do not meet the Certificate of Occupancy deadline then they may pay the AHIF rather than meet the IHO obligations, provided they comply with the overall transition process, including having approved building plans and paying the AHIF by January 31, 2020.

*Projects with Tentative Maps*

A proposed new subsection will be added to Section 13 of the AHIF resolution to provide a modified transition process for the residential developments with condominium-type tentative maps to allow for monitoring until certificate of occupancy to ensure the project remains a rental development.

Under the AHIF regulations, projects could be listed as rental projects and thus subject to the AHIF, even if the project had a tentative map allowing creation of for-sale condominiums. Under the IHO, projects with tentative maps creating separate residential condominiums are considered for-sale by definition. In the implementation of the transition period, it was determined that only those projects with tentative maps creating residential condominiums (and similar divisions) before the end of the transition period (June 30, 2018) will be eligible to pay the AHIF to satisfy their transition obligation, provided they have not proceeded with further approvals to condo map the project. Thus, an affordable housing agreement must be executed and these projects will be monitored until Certificate of Occupancy, to ensure that they do not flip to a for-sale development. If the development converts to a for-sale development, the project would be subject to the IHO for-sale In-Lieu fee. A Certificate of Occupancy would not be released until the adjusted fee is paid.

*Downtown High-Rise Projects*

A proposed new subsection will be added to Section 13 of the AHIF resolution to provide a modified transition process for the Downtown High Rise Projects that will allow projects that do not meet the Downtown High Rise Deadline to pay the AHIF if they have obtained building permits by June 30, 2021.

Under the current AHIF program, Downtown High-Rise rental developments must obtain issuance of all Certificates of Occupancy on or prior to June 30, 2021 to qualify for the deferral of their AHIF obligation. Subsequent to City Council approval of this requirement, staff received a request to allow developments that did not meet the June 30, 2021 Certificate of Occupancy deadline to pay the then current AHIF instead of defaulting to the IHO. Thus staff is recommending that if the Certificate of Occupancy deadline is missed, the qualified Downtown High-Rise rental project may default to paying the impact fee if the initial AHIF transition program requirements were met. In order to calculate the final square footage and then pay the then current AHIF, these projects must have final approved building plans by June 30, 2021. If final approved building plans are not available by June 30, 2021, then the project will be subject to the IHO requirements.

If this recommendation is not accepted, then Downtown High-Rise rental projects will need to pay fees that they did not account for upfront. According to developer feedback, a project's financial plan typically assumes that if the deadline is missed, the payment of AHIF is required. It is unclear what impact having a higher unanticipated IHO In-Lieu fee at the Certificate of Occupancy stage would have on the completion of the Downtown High-Rise. Rather than create more uncertainties for Downtown High-Rise rental projects, staff is recommending that developers of such projects be allowed to remain under the AHIF program and retain eligibility to pay the impact fee as originally planned under the transition program.

If the resolution is adopted the following changes will apply to transition projects that qualifying as AHIF Downtown High-Rise rental developments:

- 1) If the an otherwise eligible project fails to obtain its final Certificates of Occupancy for the residential development by June 30, 2021, the project will be required to pay the Affordable Housing Impact Fee on or prior to June 30, 2021.
- 2) If for any reason that residential does not have Building Permits for the residential development by June 30, 2021, then the project would be subject to the Inclusionary Housing Ordinance requirements.

*Projects with 3 to 19 Units*

Additionally, there was a need to clarify that rental developments with 3-19 units are still subject to the AHIF. The IHO only applies to projects with 20 or more units and thus rental projects with 3-19 units do not need to apply to be considered an AHIF transition project. Rental developments

with 3-19 units still need to submit an Affordable Housing Compliance Application and follow the AHIF program requirements. Thus, staff is proposing to amend the Housing Impact Fee Resolution to clarify that rental projects with 3-19 are still subject to AHIF.

### **Clarification of Requirements for Projects that Choose the IHO On-site Compliance Option**

According section 5.08.470 of the IHO, to be considered under the On-site compliance option, 15% of the single-family detached inclusionary units shall be equally dispersed throughout the residential development. For rental units, townhouse, row-house, and multifamily projects, inclusionary units must be located so as not to create a geographic concentration within the residential development. Thus, if inclusionary units were located in a separate building from market rate units, the project would not satisfy the IHO On-site compliance option because the inclusionary units are not equally dispersed. However, the project may instead address its obligations by providing those inclusionary units in a manner that meets the requirements of the applicable Off-site compliance option. This is calculated at 20% of the total project units.

Since this definition of On-site is already clearly stated in the approved IHO, there is no need to change the approved Ordinance. The On-site compliance option will be further clarified in the IHO Implementation Guidelines.

### **EVALUATION AND FOLLOW-UP**

If City Council approves staff recommendations as outlined in this memorandum, the Housing Department will update its IHO Implementation Guidelines accordingly, for approval by the City Manager.

### **POLICY ALTERNATIVES**

|                                      |                                                                                                                                                                                                                                    |
|--------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Alternative:</b>                  | Do not adopt a resolution that amends the Affordable Housing Impact Fee Resolution regarding the transition between the Affordable Housing Impact Fee and Inclusionary Housing Ordinance Programs.                                 |
| <b>Pros:</b>                         | The Housing Department and the City Attorney's Office would not have to modify the current process, thereby saving staff time.                                                                                                     |
| <b>Cons:</b>                         | This would create an inconsistency in determining affordable housing obligation(s) of residential development projects. Also it would create difficulty tracking projects through the transition process between the AHIF and IHO. |
| <b>Reasons for not Recommending:</b> | The proposed changes make the AHIF consistent with the IHO program, providing clarity to the Housing Department, developers, and other stakeholders regarding the transition between the AHIF and IHO programs.                    |

## **PUBLIC OUTREACH**

Since July 2017, the Housing Department has hosted five outreach meetings to members of the development community and other stakeholders to discuss the implementation of the AHIF and IHO programs, totaling 104 attendees.

| Meeting Date      | Attendees  |
|-------------------|------------|
| July 20, 2017     | 27         |
| October 13, 2017  | 20         |
| November 15, 2017 | 18         |
| January 12, 2018  | 28         |
| March 9, 2018     | 11         |
| <b>TOTAL</b>      | <b>104</b> |

Additionally, on October 20, 2017 and March 16, 2018, the Housing Department attended PBCE's Developers Roundtable meeting and provided information and sought input from more than 30 attendees each time the Roundtable was convened. Housing Department staff have met in-person with an estimated 30 individual developers since October 2017 to discuss their projects and the AHIF/IHO Transition Process. Finally, this memorandum will be posted on the City's Council Agenda website for the May 8, 2018 Council Meeting.

## **COORDINATION**

This item has been coordinated with the City Attorney's Office, the Office of Economic Development, the department of Planning, Building and Code Enforcement, and the City Manager's Budget Office.

## **COST IMPLICATIONS**

There are no revenue or expense impacts in 2017-2018 as a result of the recommendations. If City Council approves the recommendations, more projects could qualify under AHIF resulting in revenue anticipated in future years to be collected sooner.

## **COMMISSION RECOMMENDATION/INPUT**

The Housing Department presented initial modifications to the AHIF and IHO programs to the Housing and Community Development Commission (HCDC) on August 10, 2017.



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**CEQA**

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

/s/

JACKY MORALES-FERRAND

Director, Housing Department

For questions, please contact Amy Chen, Senior Development Officer at (408) 975-4489.

## ATTACHMENT A

### Downtown High-Rise Incentive Area

