City Council: 03/19/19
Item: 4.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

To: **CITY COUNCIL**

From: Mayor Sam Liccardo

Subject: **HOUSING CRISIS WORKPLAN – HIGH-RISE RESIDENTIAL FEE ADJUSTMENT**

Date: March 15, 2019

Approved:

RECOMMENDATION

1. Direct staff to update the High-Rise Residential Incentive Analysis completed in September 2018 consistent with the City's agreement on Private Development Workforce Standards.

2. Return to the Council with recommendations based on the updated findings of the Analysis including the following:
   a. Temporary tax and fee reductions or exemptions for residential high-rise projects demonstrated to be infeasible under the current tax and fee structures.
   b. Allowing fees to be paid at the time of certificate of occupancy.

BACKGROUND

The rising costs of development—land, labor, and materials—have stalled several housing projects from construction in San José, as home builders cannot obtain financing because their pro-formas cannot meet the hurdle rates demanded by investors and lenders. In particular, the high-rise residential analysis that was conducted by an independent consultant in September 2018 paints a bleak picture of the feasibility of such development in San José's downtown.

Even by reinstituting a partial suspension of City taxes, and by deferring the timing of the payment of fees to the certificate of occupancy, prohibitively high construction costs may still prevent any high-rise development from getting out of the ground. Construction costs have only continued to increase despite the stalling of rent growth since the completion of last September's analysis. Additionally, after the inclusionary housing exemption for high-rises expires in June 30, 2021, the probability of high-rise residential development becomes far-fetched.

By way of illustration, the Keyser Marsten analysis shows that a 300-unit high-rise would have paid some $6.42 million in fees (assuming the prior a partial suspension of City taxes), and would pay $7.32 million now that the tax reduction program has expired. That project, under their analysis, would be infeasible. Once the inclusionary zoning exemption expires, the same high-rise will pay another $7.5 million—for a total of $14.82 million—in fees. In every case, financing the construction appears infeasible. Although the inclusionary housing exemption for high-rises does not expire until June 30, 2021, projects starting construction today are extremely unlikely to be completed in time to utilize this exemption.

Adjusting the timing of fee-collection can help modestly; by allowing developers to pay City fees and taxes at the time of certificate of occupancy, we can potentially reduce financing costs on the same development by up to $1.5 million on high-interest construction loans.

Our 25,000-home housing goal depends heavily on the market's ability to produce half of the units in Downtown, where we can boost transit-oriented densities without neighborhood opposition, and where development maximizes fiscal and environmental sustainability. Doing so also aligns with our goals of making Downtown more vibrant, supporting local retail and restaurants with thousands of new residents, and providing housing for a growing employment base there.

We all would like nothing more than for downtown development to also help us build more affordable housing, where we currently have four separate 100% affordable projects under construction. However, getting 15% of nothing—the impact of our current inclusionary rules—does not move the needle on that objective. An alternative approach—perhaps one that shifts construction tax revenue into affordable housing funding—may do far more.

We would like to see staff analyze and consider the following for a new, improved downtown high-rise feasibility fee adjustment:

- Temporary reduction of construction taxes for high-rises by 50%, similar to the last high-rise program, and redirection of the remaining construction tax revenue from high-rise residential development to an affordable housing fund.
- Simplifies the fee adjustment eligibility so that occupancy is the only milestone requirement.
- Establishes an inclusionary housing escalator fee structure that begins with complete exemption for high-rise developers that achieve near-term occupancy, and perhaps incorporates requirements for some inclusion of smaller studio units likely to rent at substantially lower market rates.
- Allows developers to pay fees and taxes at the certificate of occupancy.