



Memorandum

TO: COMMUNITY & ECONOMIC
DEVELOPMENT COMMITTEE

FROM: Chris Burton

SUBJECT: SEE BELOW

DATE: June 10, 2019

Approved

Date

June 14, 2019

**SUBJECT: UPDATE ON CITY COUNCIL POLICY PRIORITY #21: IMPACT FEE
DEFERRED PAYMENT PROGRAM FOR HOUSING**

RECOMMENDATION

Accept this memorandum that provides an analysis of moving the time of payment of development related fees and taxes from the issuance of building permits to the issuance of a certificate of occupancy.

BACKGROUND

On September 28, 2017, the Mayor issued a memorandum entitled "Responding to the Housing Crisis." This memo identified a large number of items to address the housing crisis and directed staff to identify which items could be implemented within an existing work program, which items required additional resources and prioritization at the October 17, 2017 Priority Setting Session, and which items would consume undue staff time, public cost, or risk that would outweigh the likely benefit.

On October 12, 2017, Staff wrote a supplemental memo to City Council which identified 1) which items were "green light" items that staff would add to their department workplans; 2) which items were "yellow light" items that should be prioritized, and 3) which items would consume undue staff time, public cost or risk that would outweigh the likely benefit. On October 17, 2017, City Council voted on those items that were considered "yellow" light as part of the Council Priority Setting Session. Of the seven "yellow" light items, two moved forward to prioritization and five did not receive sufficient votes to move forward.

On June 12, 2018, staff brought forward the proposed Housing Crisis Workplan, which incorporated strategies from the Affordable Housing Investment Plan. At that time, the City Council approved the Housing Crisis Workplan and directed staff to return with an update to the full City Council through the Community and Economic Development Committee in February 2019.

On February 25, 2019, staff brought forward the Housing Crisis Workplan Update to the Community and Economic Development Committee. The update to the Housing Crisis Workplan included the ongoing exploration of the City's impact on the cost of residential development, which incorporated work on the deferral of fees to Certificate of Occupancy.

In 2017, Keyser Marston Associates (KMA) conducted a cost of development market analysis for residential development within the City of San Jose and followed with a Downtown-specific study in September of 2018. These studies analyzed the market and city-associated costs of residential development including an analysis of city fees and taxes. KMA explored how the timing of the payment of fees and taxes, specifically from the time of the issuance of Building Permits as is currently done on most fees and taxes, to the time of occupancy of the building, affects the cost of development. As deferral of the payment of fees and taxes has the potential to benefit the construction of residential development, deferring impact fees was incorporated in the Housing Crisis Workplan and identified as a City Council priority (#21).

ANALYSIS

Existing Development Related Fees and Taxes

The City has a number of development related fees that range from fees for service to taxes and mitigation, or in-lieu fees. For the purposes of the current analysis, staff is focused on five types of development-related fees:

Housing Impact In-Lieu Fees

- **Inclusionary Housing In-Lieu Fee:** The City's Inclusionary Housing Ordinance applies to developments with 20 or more units and requires that residential developers provide 15% of housing units at rents affordable to low-and moderate-income households or an in-lieu fee based on a 20% requirement. These fees are due after construction and prior to the issuance of a certificate of occupancy.
- **Affordable Housing Impact Fee Transition and Pipeline Exemptions:** This fee applies to multi-family rental developments with three to nineteen units. Projects currently subject to this fee have Housing Compliance Plans with the Housing Department which require that the impact fee is due prior to the issuance of Building Permits. As this program is anticipated to sunset in June of 2021 after changes to the Inclusionary Housing Ordinance, no change is proposed to this fee or the existing compliance plans.

Park Impact In-Lieu Fee

San Jose's Park Impact Ordinance/Park Dedication Ordinance requires residential developers to provide three acres of parkland per 1,000 new residents or pay an in-lieu

fee. Payment of this fee is due prior to the issuance of Building Permits; unless an alternate time for payment is identified in the schedule of Parkland Fees.

Traffic Impact Fees

San Jose has adopted traffic impact fees for Transportation Development Policy Areas. These fees are identified by policy area and are due at the issuance of Building Permits.

Development Construction Taxes

Residential projects are subject to construction taxes totaling a percentage of building permit value in addition to a per unit fee. These fees are due at the issuance of Building Permits.

Development Permitting Fees

Development projects are subject to development permitting fees associated with recovering City costs associated with entitlement, plan check, permit review, and inspections. These fees are due at the time of City-staff associated work and as they are specifically to recover costs, no change is proposed to the payment timing of these fees.

Cost of Fees and Taxes at Permit Issuance

As fees are typically financed with equity, which requires a return once it is funded, the carrying cost during the construction period effectively increases the cost of development fees. The Downtown High-Rise Residential Incentive Analysis by KMA in September of 2018 analyzed the savings that could occur with the deferral of fee payment and found that for Downtown high-rise residential projects, the carrying cost of the construction period increased the cost of development fees nearly 25% over two years (based on a 12% rate of return). For Downtown projects, this results in an increased cost of nearly \$5,100 per unit, from \$21,400 to \$26,500 per unit when the cost of capital is included. The KMA study found that if fees were paid at the end of the construction phase when the certificate of occupancy is issued by the City, which might be two or more years after when the fee would normally be paid, then the developer does not have to fund the return on equity of the fee payment during the construction period. Deferral of fees enhances the return over time to the developer and investor which could make a project more attractive to finance.

The process to defer each of these fees varies based on the Municipal Code requirements that regulate each fee. In order to defer the payment of these fees, staff would also need to establish a system to be able to ensure that the fees are paid when due after construction; with the current requirement to pay at the issuance of Building Permits, there are several regulatory milestones to ensure fees are paid. Staff is preparing to bring forth proposed ordinance changes to City Council in Spring of 2020.

Potential Changes

Staff's intent in modifying the timing of payment of fees is to enhance development feasibility by offsetting potential costs, but also to provide transparency and predictability by aligning the requirements that residential developers must meet. In aligning the payment of these major fee categories, staff is currently exploring the following adjustments.

Fee	Regulating Ordinance	Currently Due	Potential Change
Inclusionary Housing Fee	Ch 5.08	Post-Construction, at Certificate of Occupancy	No change
Affordable Housing Impact Fee	Resolution 77218 as amended	Issuance of Building Permits	No change
Parks Fee	Ch. 14.25 & Ch. 19.38	Issuance of Building Permits	Defer to Certificate of Occupancy
Traffic Impact Fee	Ch 14.29, Ch. 14.30, & Ch14.33	Issuance of Building Permits	Defer to Certificate of Occupancy
Construction Taxes	Ch. 4.46, Ch. 4.47, Ch. 4.54, & Ch. 4.64	Issuance of Building Permits	Defer to Certificate of Occupancy
Permitting Fees		At time of City-staff work	No change

Next Steps

Staff is in the process of updating the KMA studies to reflect the current market conditions to inform the larger conversation of what actions the City may undertake to incentivize the construction of housing units. This Cost of Development work is expected to be presented to the City Council in September of 2019. In addition, staff is working on developing an approach to Council Priority #12 on the development of a Universal Development Fee. Staff is currently working on aligning these items to better understand potential efficiencies and opportunities for continued improvement. As part of the focused Council meeting on housing related policy items, staff will bring forward the next progress update on these two items.

EVALUATION AND FOLLOW-UP

City staff will continue to work towards deferring the payment of impact fees to after the construction phase of development, prior to the issuance of a certificate of occupancy. Staff will report on this work to the full Council in September of 2019 in conjunction with the Cost of Development work currently underway.

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COORDINATION

This memorandum has been coordinated with the Department of Planning, Building and Code Enforcement, the City Attorney's Office, the City Manager's Budget Office, the Department of Housing and the Department of Parks, Recreation and Neighborhood Services.

/s/

CHRIS BURTON

Deputy Director

Office of Economic Development

For questions please contact Emily Lipoma, Development Facilitation Officer at (408) 535-7903.