CITY OF SAN JOSE

CAPITAL OF SILICON VALLEY

Housing

Downtown Residential High-Rise Inclusionary Housing Ordinance Fee

November 5, 2019

Item 4.6

Rachel VanderVeen

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Chris Burton

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Background

- **2014:** Affordable Housing Impact Fee (AHIF) Adopted

  Included time limited exemption for Downtown High-Rise rental projects:

  - Provides evidence that development is not for-sale development
  - Records an Affordable Housing Impact Fee Agreement prior to issuance of Building Permit, and
  - Final Certificates of Occupancy ready to issue on or prior to June 30, 2021

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Prior Council Direction

June 2019: Workforce Standards

- Move forward with a unique services agreement for a consultant to perform the required financial feasibility assessment of Downtown high-rise residential Sub-Category – return on August 6, 2019.
- 14.10.060 Financially Infeasible: “Financially Infeasible” means that the ***typical*** Private Construction Projects, as that term is defined in Section 14.10.090 of this Chapter 14.10, in a Subcategory of Use, as that term is defined in Section 14.10.100 of this Chapter 14.10, are not likely to be built absent a reduction in fees and/or taxes applicable to the Projects.

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Prior Council Direction

September 2019: Downtown High-Rise Exemptions

- Extend the certificate of occupancy deadline for the Affordable Housing Impact Fee to December 31, 2023
- Create a temporary 50% reduction of the Building and Structure Construction Tax and 50% reduction of the Commercial-Residential-Mobilehome Park Building Tax that obtain a certificate of occupancy by December 31, 2023

Report Findings

- **Treating downtown high-rises as subject to the Inclusionary Housing Ordinance (IHO), instead of the Affordable Housing Impact Fee, could increase development costs by an additional two percent.** Assuming the developer chooses the in-lieu fee option in the IHO, in-lieu fees would equate to $25,000 per unit, or $10,392 higher than the AHIF.

IHO Eligible Projects

Project	Developer	Type	Number of Units	Square Footage	If Paying IHO FY 19-20 ($125K/unit)
Garden Gate	KT Urban	Multi-Family	290	280,616	$7,250,000
		Co-Living	793	200,550	$19,875,000

Meeting the Ordinance Requirements

Requirement		Consultant Analysis
a.	Whether construction of the Private Construction Projects in the specified Subcategory of Use is Financially Infeasible;	Under current conditions, a typical high-rise development in downtown San José is not financially feasible.
b.	The reason(s) for any conclusion that construction of the Private Construction Projects in the specified Subcategory of Use is Financially Infeasible;	The yield-on-cost for Scenario 1 is 4.13% short of the target return of 5.25%. This is mainly due to the escalating cost of construction in the current market environment, currently estimated at $651,000 per unit for a development of this type.
		With the current high level of development costs, average rents would need to increase by 20 percent (to $4.80 per net square foot or $3,840 per unit monthly) for the development to be feasible given current costs.

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Meeting the Ordinance Requirements

Requirement		Consultant Analysis
c.	The anticipated duration of any condition(s) making construction of the Private Construction Projects in the specified Subcategory of Use Financially Infeasible;	As rental rates over the last ten years have averaged 4.6 percent annual growth (see Figure 5), it may require a few years of favorable conditions (strong rental market combined with flat development costs) to reach feasibility.
d.	The estimated size of the financial gap between the Private Construction Projects in specified Subcategory of Use being Financially Infeasible and financially feasible;	A 21 percent reduction in total development costs (or $138,000 reduction per unit) would be required for a development of this type to be feasible.

Meeting the Ordinance Requirements

Requirement		Consultant Analysis
e.	Options for making construction of the Private Construction Projects in the specified Subcategory of Use financially feasible, including the following:	
	I. Providing the proposed fee or tax reduction without requiring the payment of prevailing wages;	Extending the incentives improves the financial picture slightly by is not sufficient for the development to reach feasibility.
	II. Providing the proposed fee or tax reduction along with requiring the payment of prevailing wage; and	Including workforce standards increases development costs by 4%.
	III. Any additional options, other than the proposed fee or tax reduction, that would make construction of the Private Construction Projects within the specified Subcategory of Use financially feasible, provided that any such option must comply with all applicable laws and regulations, including the City's current general plan.	The options would not make construction of the Private Construction Projects within the specified Subcategory of Use financially feasible. The three variables that were directly explored in the report were: • No incentive and no workforce standards • Incentives only • Incentives and workforce standards implemented

Recommendation

- Accept the report on the Downtown High-Rise Feasibility Assessment and direct the Administration to return to Council with the appropriate resolutions to establish an in-lieu fee for Downtown High-Rise (Rental and For-Sale) under the Inclusionary Housing Ordinance in the amount of $0, with annual increases to that in lieu fee, returning the Downtown High-Rise In lieu fee to the full amount by June 30, 2025; to make all of the required findings, and to amend the schedule of fees and charges accordingly.

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Development Feasibility

$$\text{Yield on Cost} = \frac{\text{Net Operating Income}}{\text{Total Development Cost}}$$

Target Yield Cost = **5.25%**

1. No Incentive, no workforce standards	2. Incentives only	3. Incentives + workforce standards
$27,000	$27,000	$27,000
$651,000	$632,000	$675,000
4.15%	4.27%	4.00%