Inclusionary Housing Ordinance
KT Urban Memorandum
Agenda Item 8.2
February 23, 2021

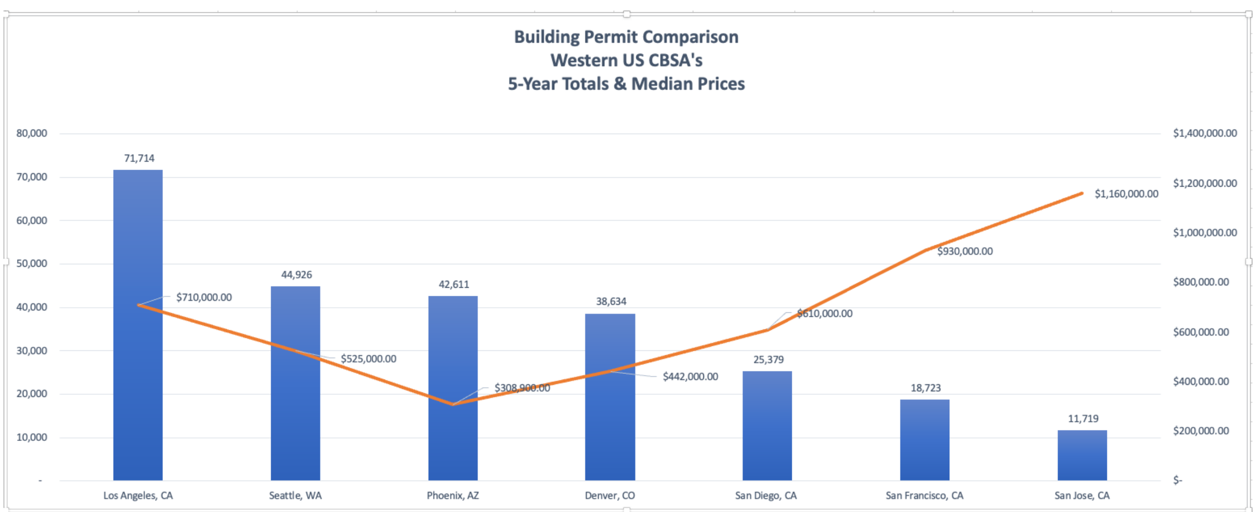
Introduction

We applaud the City's efforts to modify the Inclusionary Housing Ordinance ("IHO") especially the change from per unit to per square foot calculations. However, the modifications will result in some projects incurring higher fees without understanding the consequences of these changes. The feasibility of the IHO and its impact on housing production, both market rate and affordable, is tantamount to this discussion. Furthermore, the Council should consider the pipeline of approved projects and exempt them from additional fee increases especially during the COVID pandemic. We also hope that the Council will seek to offset the cost of the IHO with incentives such as increasing allowable heights and densities as well as reductions in required commercial space.

When evaluating the proposed changes to the Inclusionary Housing Ordinance, we hope that you ask one simple question: how will the proposed changes increase the housing supply for both market rate and affordable housing in San Jose?

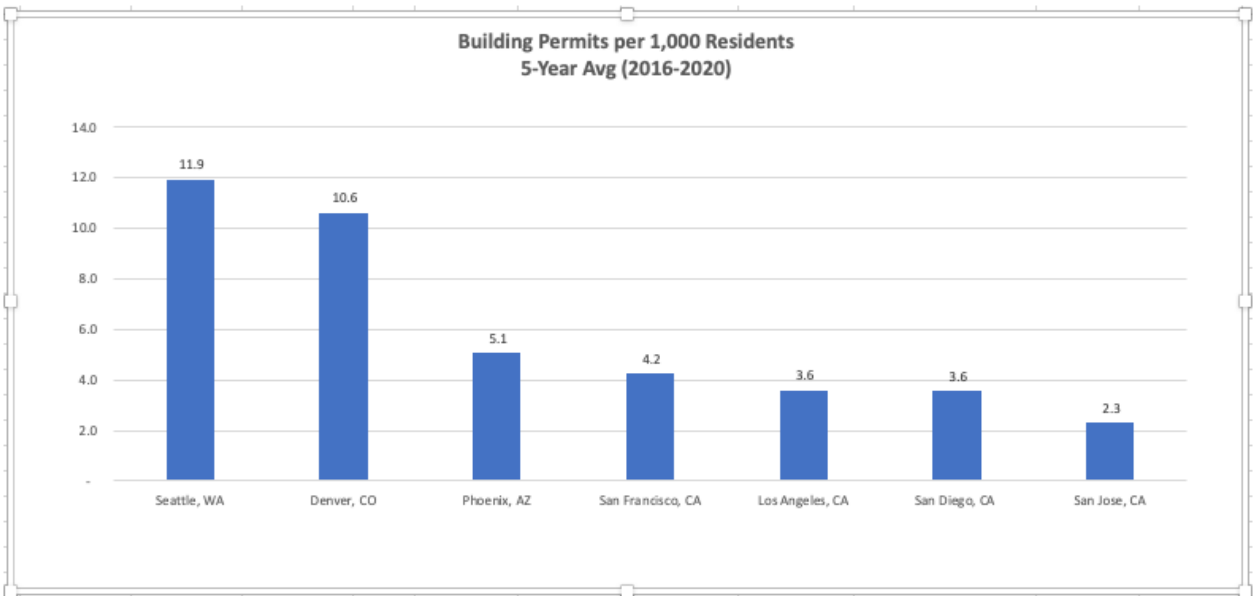
Background

Over the last five- and ten-year periods respectively, San Jose produced the lowest amount of building permits among the major Western US markets contributing to some of the highest median home price in the US. The City of San Jose's ability to produce housing is clearly broken and the costs are too high. Instead of continuing to tweak well-intended, but failed, policies that restrict our supply, we must seek out a new direction if we are to meet our goals of reducing the housing burden for many of our families.



The City adopted an Inclusionary Housing Ordinance in January 2010. The Inclusionary Housing Ordinance generally taxes new home construction in the hope of producing more subsidized housing for eligible buyers and renters. While it's difficult to find studies that evaluate the impact of inclusionary housing policies on supply, economic theory suggests that new taxes on housing would result in less supply and higher prices. In other words, it stands to reason that the City's fee structure is inhibiting new construction projects from reaching acceptable return metrics in order to attract capital in the marketplace.

The building data supports the assertion as the City's housing production continues to fall despite the region's record economic growth. If we look at the City of San Jose's building activity from 1980 to 2009, the City produced an average of 3,027 building permits over this thirty-year period. Since the adoption of the inclusionary housing ordinance in 2010, the City's production fell 13% to an average of 2,643 units over the ten-year period from 2011-2020 and by an additional 300 units per year (2,344 average) from 2016-2020.



The inclusionary housing fee, park fee and construction taxes in San Jose are the primary drivers of impact fees in the City of San Jose constituting approximately 60-80% of the fee burden. According to the Terner Center for Housing Innovation at UC Berkeley in *It All Adds Up: The Cost of Housing Development Fees in Seven California Cities* in March 2018, the cities of San Diego and Los Angeles have significantly lower impact fee burdens than San Jose and have produced substantially more supply. The median home prices are also significantly lower.

The City of Seattle which is most similar to San Jose in terms of economic base, geographical constraints, and demographics produced nearly 3.8x the number of building permits from 2016-2020. Seattle doesn't have impact fees and the affordable housing fee is offset by an increase in building heights in the downtown core where most of the volume has been produced. Seattle also offers MFTE, the Multifamily Tax Exemption, which allows new developments to be tax exempt (not land) for a period of time (typically 12 years).

In September of 2017, Mayor Liccardo wrote a memo entitled *Responding to the Housing Crisis*. This bold memo called upon the City of San Jose to build 25,000 homes and 10,000 affordable units by 2022. The Mayor states that the inclusionary housing ordinance could generate 3,750 affordable units by hitting the 25,000 goal. Since the memo, the City has fallen well short of the Mayor's goal producing only 6,550 building permits (26%) from 2018-2020. The peak number of permits issued was 2,836 in 2018—far short of the 5,000 permits need annually to meet the goal.

In order to stimulate increased residential construction, the City must move away from taxing housing and find alternative funding sources for subsidizing affordable housing. The Mayor's memo rightly calls out *Aligning Fees to Encourage Housing Production* as a primary driver of increasing supply. We agree and applaud the City's efforts to modify the inclusionary and park fees such that the fee is based on square feet rather than units. However, the overall fee burden has not decreased and was initially set at a level that discouraged new housing. Furthermore, once enacted, a fee has a natural tendency to continue to rise despite the impacts on housing production. We are seeing this tendency come to life in the Housing Department's recent modifications to the Inclusionary Housing Ordinance in real time.

The City Council must balance priorities especially when the goal of City departments may not align with the overall health and general welfare of the City. For example, the Park Department's goal is to build more parks and the Housing Department's goal is to finance subsidized housing, not promote housing production. Recognizing the inherent conflict here is critical to finding equitable solutions. We would hope that the Economic Development department would serve as an arbiter here, but in many cases, ED has remained silent and supported policies which do not promote housing and serve to drive our human capital out of the region in search of more affordable housing.

The City continues to discuss the concept of a development fee framework or universal development fee. In concept, a universal fee would be easy to calculate and provide certainty when developers are evaluating potential projects. However, a universal fee or development fee framework will only help meet the City and the Mayor's goal if fee levels are reduced significantly below the levels imposed today on new housing construction.

In 2020, the State made significant progress in stimulating housing production. Unfortunately, many believe that the legislature fell far short in its efforts to address the housing crisis especially with the defeat of SB 50. More work needs to be done and the City needs to continue to advocate for change in Sacramento. We believe that CEQA reform, local zoning reform and increased tax increment financing for affordable housing are critical to our collective efforts. For example, urban infill developments should be exempt from CEQA and those who are victims of frivolous CEQA lawsuits should be provided recourse under the law. Meanwhile, the City must act and tear down the barriers that it has created to producing housing at all income levels.

Conclusion

State Senator Scott Weiner is often quoted as saying that the "no growth trope" is that you can solve the housing crisis by building subsidized housing alone. It's clear that only robust market-rate housing production can alleviate our housing crisis and help assist the most vulnerable in our community.

"While affordable housing programs are vitally important to the households they assist, these programs help only a small fraction of the Californians that are struggling to cope with the state's high housing costs. The majority of low-income households receive little or no assistance and spend more than half of their income on housing."

In February 2016, the CA Legislative Analyst's Office, a non-partisan advisory office, released the report entitled *Perspectives on Helping Low-Income Californians Afford Housing*. The report was a follow up to its causes and consequences of the California housing shortage published in 2015. In short, the only way to stem displacement is to build more housing in supply constrained markets like San Jose. Furthermore, the report seeks to address the concern that new housing supply does not increase the supply of more affordable housing. The report concludes that new construction has the overall effect of keeping rents low for existing tenants and adds to the supply of affordable housing by slowing rent growth in older neighborhoods.

"When new construction is abundant, middle-income households looking to upgrade the quality of their housing often move from older, more affordable housing to new housing. As these middle-income households move out of older housing it becomes available for lower-income households. This is less likely to occur in communities where new housing construction is limited."

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Contra Costa Centre Transit Village
1350 Treat Blvd., Suite 140
Walnut Creek, CA 94597

Mayor Sam Liccardo & San Jose City Council
200 E. Santa Clara St.
San José, CA 95113
Transmitted via EMAIL

February 17, 2021

RE: February 23, 2021 Council Agenda #8.2: Inclusionary Housing Ordinance Proposed Amendments

Dear Mayor Liccardo and San Jose City Councilmembers,

BIA Bay Area (BIA), representing for-sale and rental residential builders who constitute a primary housing production stakeholder's group in San Jose, continues to be very concerned regarding the interpretation, implementation and proposed revisions of City of San Jose's Inclusionary Housing Ordinance (IHO). The proposed amendments must be viewed as a fee increase, especially the proposed $43/sq. ft. in lieu fee on market rate multifamily rental housing.

BIA urges the City Council to acknowledge the devastating housing production state of affairs that currently exists in San Jose. Housing production, measured by building permits issued, has fallen consistently for the last four years. In 2020, building permits fell 40% – one of the biggest drops in the Bay Area. No amount of tinkering with the City's flawed Inclusionary Housing Ordinance will change this dynamic.

In 2018, BIA endorsed the call for comprehensive study sessions to address the rising cost of impact fees, including affordable housing fees, and the need to align those fees both regionally and within the City's fee structure. Projects need more certainty and predictability in proforma development. Impact fees and affordable housing requirements have become a substantial percentage of overall costs with detrimental effect to the ability of a housing development project to meet financial viability.

Terner Center Report

The Terner Center for Housing Innovation at UC Berkeley has concluded in its March 2018 report, *"It All Adds Up: The Cost of Housing Development Fees in Seven California Cities"*, individual fees add up and substantially increase the cost of building housing. Findings from this report show that development impact fees have significant implications for the cost and delivery of new housing in California. For example, Terner Center research found that total fees can amount to anywhere from 6 percent to 18 percent of the median price of a new home depending on location.

A handful of well-intended policy proposals from the Housing Department seem to recognize the dire situation that San Jose finds itself regarding the feasibility of housing production, but there are other significant policy proposals that persist in stifling housing projects. After reviewing competing feasibility studies, it is quite clear that the City of San Jose has helped create this negative environment.

BIA would encourage the City Council to avoid taking action that deteriorate the situation further and offers recommendations to help strengthen and improve the current IHO.

BIA supports Staff Recommendations:

- Covert in lieu fees to per square foot assessment from per unit assessment;
- Make *all* City impact fees payable at Certificate of Occupancy;
- Provide more developer options by allowing split compliance (some units + some fees);
- Residential developments with planning permit approvals prior to May 1, 2021, will remain under the current Inclusionary Housing Ordinance.

- **Additional BIA Recommendations**

  - No Fee Increase - maintain current in lieu fees at about $25 per square ft. for both rental and for sale units in Strong Market areas:
    - High in lieu fees will push more projects in San Jose toward infeasibility;
    - San Jose current fees are within the average of neighboring jurisdictions;
  - Decrease Moderate Market in-lieu fees;
  - Limit the term of affordability to 55 years;
  - Permit clustering of affordable units;
  - Exempt <u>all</u> affordable units from PDO/PIO fees or requirements;
  - Apply the fee only to “net rentable/livable” square footage

The above recommendations sum up reasonable reforms to the IHO that will allow projects to actually get through the pipeline and more housing to be created.

- **Market based approach is a step in the right direction**

In 2019, the City is finally turning toward a market-based approach that is backed by data. Analyzing feasibility data by sub region, i.e., West Valley, Willow Glen & Cambrian, Downtown, East/South San Jose is a preferable approach to a blanket approach to development across the City.

- **Proposed multifamily in lieu fees are out of step with neighboring jurisdictions**

BIA, however, opposes the proposed revision of the IHO because the proposed in lieu fees for multifamily are much higher than current fees. The City’s proposed $43/sq. ft. in lieu fee for multifamily is significantly above neighboring cities’ current in lieu fees, much higher than the average of neighboring jurisdictions:

City	Multifamily (Sq. Ft.)	Condo (Sq. Ft.)	Term (years)
Cupertino	$20.00	$25.00	99
Fremont	$17.50	$27.00	55
Milpitas	$33.00	$33.00	55
Santa Clara	$20.00	$25.00	55
Sunnyvale	$25.00	n/a	55
San Jose Current	~$28.00	~27.00	55
Average	**$23.90**	**$22.80**	**55**
San Jose Proposed	**$43.00**	**$25.00**	**99**

San Jose's In-lieu proposed fee runs 50% higher or more than the comparable neighboring cities. San Jose does not have the rental valuations to charge fees in the same ranges as San Francisco, Palo Alto & Mountain View. BIA recommends lowering in lieu fees on multifamily projects across the City.

- **A 99-year term of rent restrictions compromises project financing**

Developers have commented that financing is compromised if the Term of Rent Restrictions goes beyond 55 years. Although the City surveyed surrounding cities and found some who have "in perpetuity", or "99 years", most neighboring jurisdictions set the term of affordability at 55 years. Many surrounding smaller Silicon Valley cities, such as Cupertino, are cities that do not to facilitate the development of affordable housing in their communities.

Silicon Valley's substantial lack of an adequate housing supply, both market rate and affordable, is a region-wide as well as state-wide problem and is the most significant factor contributing to the escalating cost of housing. Proposed revisions to the IHO will do nothing to increase the production of deed restricted or market rate housing.

By proposing an in-lieu fee increase, the City guarantees that if the affordable percentage and in-lieu fees are pushed ever higher, it is likely to have the unintended consequence of worsening the City's (and the region's) housing outlook by sparking a spate of fee increases, eliminating market-rate projects in the pipeline, and driving more and more projects toward infeasibility.

BIA Bay Area is ready to work with the City to fine tune the Inclusionary Ordinance so that it is best able to work for both the City of San Jose and the building community. We hope that the City will include BIA members and representatives in the efforts outlined by the Mayor and Council in the joint memo.

Very truly yours,

[redacted]

Patricia Sausedo, Director
Government Affairs South Bay
BIA BAY AREA

Cc: City Clerk

KT URBAN

February 22, 2021

Honorable Mayor Sam Liccardo
City of San Jose
200 E Santa Clara Street
18th Floor
San Jose, CA 95113

Re: Inclusionary Housing Ordinance

Dear Honorable Mayor Liccardo,

Despite the City's good intentions in adopting an Inclusionary Housing Ordinance in January 2010, we believe that it's time to deem this policy a failure and identify permanent, predictable sources for subsidizing affordable housing. The Housing Department's efforts to tinker with this ordinance only serve to exacerbate our housing crisis by continuing to tax new housing construction, limiting housing production and producing little in the way of results for those who were initially intended to benefit.

With your leadership, the City has set a target of producing 10,000 subsidized housing units by 2022. However, since 2010, the City of San Jose's building permits have significantly lagged behind the rate of supply in other Bay Area and Western US markets. The inclusionary ordinance adds significantly to the costs of construction and is adversely impacting the City's ability to meet its housing goals.

According to a report by Beacon Economics for the SVO in 2019, the City had only collected approximately $3.2 million since the IHO's inception. How many units have been built here? Based on a $125,000 per unit subsidy, this funding would only allow the construction of 25 units! If the Housing Department were running a business, they would be bankrupt. The costs to administer this program has vastly outweighed the revenue generated under the IHO since 2010. Furthermore, none of the timing makes sense here. COVID has reduced rental rates and the continued escalation of material costs have made many projects infeasible.

The days of building single family housing in San Jose are over. Future production can only come from multifamily housing. Multifamily housing is expensive to build. Period. It's imperative that the City's fee structure align with the market realities of building this type of product. Multifamily housing requires highly skilled labor and many of the general contractors who build this product are signatories to union labor with the Carpenters and Laborers as well as other trades. How many jobs will be lost as the pipeline of construction projects wane and new projects cannot be brought online? Literally thousands of good paying jobs are at stake here.

The housing crisis is a societal problem and can only be solved like any other societal problem. Broad based tax measures will not adversely impact new housing construction and are an equitable solution for those building market rate housing and those looking to subsidize affordable housing at scale.

- We encourage the City to work with the County on adopting a transfer tax on all residential and commercial transactions which will serve as a more equitable, replacement source of funding.

- In addition, the City should work with the County on receiving its fair share of the $950 million in bond funding that was approved by Santa Clara County voters. San Jose will no doubt be building more than its fair share of housing in the County.

- Furthermore, the City should seek to revitalize redevelopment agencies for the express purpose of building subsidized housing.

These revenue stream will provide the City with more tools in the toolbox without penalizing new home construction. These funds could have a more timely, direct impact on our community and positively affect a greater number of those in need by offering rent vouchers, equity sharing programs and low interest loans. These programs can also generate returns on their investment which would help expand the pie even further.

Thank you for your consideration. Let's make San Jose a shining example of what true leadership on the housing crisis can deliver.

Sincerely,

Shawn A. Milligan
Mark E. Tersini
Kenneth S. Tersini

February 22, 2021

Honorable Mayor Liccardo and Members of the City Council
City of San Jose
200 East Santa Clara Street, 18th Floor
San Jose, CA 95113

Dear Mayor Liccardo, Vice-Mayor Chappie Jones, and Councilmembers Jimenez, Peralez, Cohen, Carrasco, Davis, Esparza, Arenas, Foley, and Mahan:

Re: 8.2 Actions Related to the Amendment of the Inclusionary Housing Ordinance.

On behalf of our members, we write today to support adoption of the amended Inclusionary Housing Ordinance, as directed by the City Council in 2019. While we believe this new policy is designed to reduce the effective IHO in lieu fee levels below levels necessary to replace the units not built, the policy amendments were designed to respond to both a challenging building environment and the Council's dual directions of getting more homes built "on-site," and to develop policies to address the needs of moderate-income households otherwise not eligible for assisted units. We believe the policy will achieve these aims, while continuing to play a role in generating funds for affordable housing development.

The policy outlined and approved by council over a year ago, takes a number of steps requested by the development community at that time, including:

- moving to a square footage fee rather than a per-unit fee,
- pushing payment out to Certificate of Occupancy,
- incentivizing some units on site in return for reduced fees,
- acknowledging the different fee feasibility in sub-markets around the city,
- and the desire to create incentives for meeting fee requirements through in-kind support of 100% affordable projects.

Staff's response to this last item may be the most consequential of the amendments over the long term. By allowing 100% affordable projects to be clustered alongside market-rate projects, the developers' financial, and in-kind contributions will now be able to leverage public funds to achieve more units at much deeper levels of affordability. Rather than collect fees that will build housing away from resource-rich growth areas, this policy will locate deeply affordable housing where the market is strongest, and is already being integrated into planning for future projects.

We strongly support the move to 99-year income restrictions, which council directed staff to explore. These inclusionary units, whether built on-site, or integrated through adjacent buildings, are an essential part of the City's response to the housing crisis. They must be enduring affordable anchors in our communities.

350 W. Julian Street, Building 5, San José, CA 95110
408.780.8411 • www.svathome.org • info@siliconvalleyathome.org

The amendments are clearly designed to incentivize the construction of 5% of the onsite units affordable to households with incomes at 100% of the Area Median Income. In return for these shallow subsidies, developers will be allowed to pay significantly lower fees – discounted nearly 75% in select strong market areas, and 40% in other areas. This will not meet the costs of building the more affordable units off site, which is the function of the in lieu fee option, but we believe it result in the development of more units on site, and will expand the city's ability to meet its moderate income RHNA targets.

As staff acknowledges in its memo, we are in a very different time and place than we were in 2019 when this policy was approved by Council. We believe that San Jose is well positioned to lead the recovery, and that housing costs will bounce back as they did after the great recession. We also believe that those hardest hit by the health and economic impact of this pandemic -- low-wage workers and communities of color – will carry this hardship with them for years to come. These are those among us who were already shouldering the heaviest burden of our housing crisis, for whom housing instability, rent burden and overcrowding were already endemic – even as their work was the undergirding of our economy. The need will be greater now, and we share a collective obligation to redouble our commitments and plan ahead.

Thank you for your consideration.

Sincerely,

[redacted]

Leslye Corsiglia
Executive Director

350 W. Julian Street, Building 5, San José, CA 95110
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Santa Clara Valley Transportation Authority

February 22, 2021

San Jose Mayor & City Council
200 E. Santa Clara St.
San Jose, CA 95113

Re: February 23rd, 2021 City Council Agenda item 8.2 Actions Related to the Amendment of the Inclusionary Housing Ordinance

Mayor & City Council Members,

In Section 5.08.590 Partnership for Clustered Units Subsection C regarding Minimum Contribution Agreement we request that Council include the following clarifying language to the ordinance, which is in **<u>bold and underlined</u>** for ease of reference:

> Minimum Contribution Agreement. If the Applicant is not an Affordable Housing Developer, the Applicant shall enter into an agreement with an Affordable Housing Developer and City, consistent with the Inclusionary Housing Guidelines which provides for a minimum contribution by the Applicant not less than seventy-five percent (75%) of the Residential Development's projected in lieu fee amount **<u>or equivalent in-kind contribution</u>** and a timeline for obtaining and closing construction financing and commencing construction prior to the earlier of the issuance of the first Certificate of Occupancy for the Residential Development or five (5) years.

Many mixed-income development partnerships include in-kind contributions from the market rate developer for the benefit of the affordable housing development partner. Examples of in-kind contributions would be entitlement expenses, architectural and engineering fees, on and off-site improvements, turn-key horizontal and vertical construction, and land value (write-down and contribution).

VTA's Transit-Oriented Development Portfolio has numerous mixed-income deal structures which benefit from in-kind contributions. It is essential that these projects and deal structure remain feasible in order to advance our mutual goals of providing as much affordable housing on VTA lands as possible. Definitive flexibility of the additional clarifying language will assist in bringing much needed housing units to market.

Sincerely,

[redacted]
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Ron Golem
Director of Real Estate and Transit-Oriented Development
Valley Transportation Authority

Republic
URBAN PROPERTIES
84 W. Santa Clara St. #600, San Jose, CA 95113

February 23, 2021

Re: Item 8.2 Proposed Amendments to IHO Policy

Dear City Council,

We write to offer our support for the proposed amendments to the Inclusionary Housing Ordinance ("IHO") and to provide two real-life examples for how the amendments will encourage and result in the construction of more affordable housing.

Prior to the amended policy, there was no real mechanism to provide on-site affordable housing in a standalone affordable building. While the concept of dispersed levels of affordability is good in theory, there are a number of economic and administrative barriers that make it difficult for market rate developers to incorporate deed-restricted housing into their market rate projects. Moreover, even if market-rate developers were to incorporate on-site IHO units (which is only beginning to happen now that density bonus laws have made it more economically feasible to do so), because each unit will result in a net loss for the developer, there is no incentive to go beyond the minimum.

With the clustered option and the ability of market rate developers to meet their in-lieu obligation through direct contributions to affordable builders, affordable housing will be promoted in the following ways:

(1) Tax credit affordable financing, which is unavailable in a mixed-income building, can be used to leverage the contributions of market rate developers such that far more affordable units will be built than if a market rate developer incorporated the IHO units into the market rate building.

(2) Because a market rate developer will only receive credit for its contributions if the affordable units are actually built, unlike in-lieu fees that are disbursed at some point in the future, it ensures that affordable units will be built at the same time as market rate units.

(3) In-lieu fees are a less efficient transfer of money than contributions. Contributions do not require the City to administer, process and evaluate affordable housing development applications. Rather, the funds go directly to the entity that will be building the IHO units without an administrative middleman.

(4) The contribution option allows market rate developers to front pre-development and site improvement costs that would otherwise require affordable developers to capitalize themselves. This reduces the necessity that affordable developers come out of pocket before public funding sources are available and it shifts more of the risk to for-profit entities that are better able to absorb pre-development and entitlement uncertainties.

As way of example, at the Blossom Hill VTA Station, Republic Urban has partnered with EAH Housing Inc.[1] to file a Signature Project application to build 239 market rate units and 89 affordable units in the place of a 7.4 acre parking lot, resulting in an overall level of affordability of 27%. The project also includes a public trail connection between Blossom Hill Road and Martial Cottle Park, transit parking improvements and a transit plaza. To date, the pre-development costs are close to $2M, all of which has been covered by the master/market-rate developer, Republic Urban.

Similarly, at Tamien Station, which is another VTA-sponsored development application, this time with Core Companies as the affordable-development partner, there will be up to 434 market-rate units and 135 affordable units at an overall affordability of 24%. As with Blossom Hill, Republic Urban has covered the entirety of the approximate $3.11M in pre-development costs to date.

When the Blossom Hill Signature and Tamien projects are constructed, the affordable units will be completed at the same time as the market rate units, which is consistent with both VTA's development policies and the City's goals of actually increasing affordable housing production – not just collecting fair share fees.

Both projects are also likely to provide additional benefits beyond providing for affordable housing. Specifically, because both projects incorporate affordable housing in close proximity to high-quality transit and the projects include significant off-site improvements that would be economically infeasible and a non-starter for a 100% affordable project, it is expected that both the Tamien Station and Blossom Hill Signature projects will be able to obtain state AHSC grants. These grants provide significant community benefits. At the Gateway to Millbrae project, for example, Republic Urban and Core were able to obtain a state AHSC grant for $18M grant which helped close the funding gap on the affordable housing project, funded hundreds of thousands of dollars in City bike trail improvements and a $2M BART tail-track extension project to reduce greenhouse gases. If Republic Urban were simply to pay an in-lieu fee based on the required IHO fee or if no clustered option were available that could include a standalone, 100% affordable building that is eligible for tax credit financing, these types of projects would be very difficult, if not impossible to replicate in San Jose.

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[1] In 2018, VTA awarded the Blossom Hill VTA Signature Project to Green Republic Blossom Hill, which is a partnership between Republic Urban Properties, EAH Housing and Swenson Builders.

In short, we support the changes and hope that City Council will adopt the policy as proposed.

Sincerely,

[redacted]

Melanie Griswold
Development Director & Sr. Counsel
Republic Urban Properties

[redacted]

Welton Jordan
Chief Real Estate Officer
EAH Inc.

[redacted]

Chris Neale
Executive Vice President
The Core Companies