



# Memorandum

**TO: HONORABLE MAYOR AND  
CITY COUNCIL**

**FROM: Leslye Krutko**

**SUBJECT: SEE BELOW**

**DATE: May 6, 2008**

Approved

Date

5-6-08

**COUNCIL DISTRICT: Citywide**

**SNI AREA: N/A**

**SUBJECT: DISCUSSION AND OVERVIEW OF THE ECONOMIC FEASIBILITY  
ANALYSIS COMPLETED AS A PART OF THE CITY'S INCLUSIONARY  
HOUSING STUDY**

## **RECOMMENDATION**

It is recommended that the Mayor and City Council:

1. Provide guidance and feedback to staff at this mid-way point in the review of a potential Citywide inclusionary housing ordinance; and
2. Accept the economic feasibility analysis study completed by David Paul Rosen and Associates related to Citywide Inclusionary Housing in San Jose.

## **OUTCOMES**

With direction from the Mayor and City Council, the City staff can begin holding public meetings to further discuss whether or not to make a recommendation to City Council for a Citywide Inclusionary Housing Ordinance for San Jose.

## **BACKGROUND**

On June 19, 2007, the Mayor and City Council adopted action items related the Five-Year Housing Investment Plans (FYHIP) for Fiscal Years 2007-2012. One of the actions included in the FYHIP was a recommendation that the City consider the feasibility of a Citywide policy for inclusionary housing.

On December 11, 2007, the City Council held a study session to adopt a public process for receiving feedback about a potential Citywide inclusionary housing program. As part of the review of this policy, the City Council approved moving forward with an economic feasibility analysis.

In preparation for this feasibility study and the public meetings, a list of over 700 individuals, developers, and community organizations was developed to share information about the study process, upcoming meetings, meeting summaries, and materials. The Department's website ([www.sjhousing.org](http://www.sjhousing.org)) contains all materials presented and distributed at the meetings, and provides a place to make online comments about the study.

The City, along with its consultant, David Paul Rosen and Associates (DRA), held three meetings to gather information from stakeholders. The first meeting, attended by approximately 30 public members, primarily focused on the prototypes, affordability set aside scenarios, and desired developer incentives (or offsets) that should be studied. This meeting became the foundation for the study and provided an opportunity for developers and interested public members to provide input into the initial phase and structure of the report.

The second public meeting was attended by 40 participants, representing nonprofit and for-profit developers, market rate developers, community organizations, and interested public individuals. At this meeting, DRA presented the draft pro forma budgets for each of the five selected development prototypes. DRA held interviews with 11 developers to collect information about recent, actual projects in San Jose and received project budgets, which were incorporated into the study and became the basis for analyzing the cost of development.

At the final meeting, attended by about 40 people, the consultant reviewed the Draft Administrative Review Plan and gave a presentation on the study findings. Attendees raised questions about the study, including whether inclusionary housing represented a taking under California State law and concerns about the assumptions made for mezzanine debt. The Homebuilders Association went on record that its members do not favor inclusionary housing policies. In response, it was stated that inclusionary housing is not a taking according to legal opinions that have been produced in response to this question. With respect to the issue of mezzanine debt, it was agreed that the mezzanine debt assumption was too low and the consultant made changes to reflect the higher numbers.

On April 16, 2008, the Mayor and Councilmember Liccardo brought forward a memorandum to Rules and Open Government Committee requesting a City Council discussion to examine the consultant's findings and discuss the next steps. The Housing Department provided a new timeline that included this discussion, which was approved by the City Council on May 6, 2008. Under this new adopted timeline, City staff is recommending more time for public review, comment, and policy formulation. The new schedule would add four public meetings: two taking place before any policy recommendation is made and two after City staff has determined its recommendation. By adding these additional public outreach meetings, the dates for the Community and Economic Development Committee and Neighborhood Services and Education

Committee will move to August or September, with a final recommendation to City Council anticipated in September or October 2008.

## **ANALYSIS**

The following analysis provides a synopsis of the findings and outcomes of the "Inclusionary Housing Analysis". A complete copy of the report can be found on the Housing Department's website at [www.sjhousing.org](http://www.sjhousing.org) under the link "Inclusionary Housing Study."

### *Purpose*

"Inclusionary housing" is a policy that requires that residential developments include a certain number (or percentage) of units affordable to low- or moderate income households. These units are typically integrated within market-rate developments. Inclusionary policies are one tool in the toolbox for providing additional affordable housing in a community. In California, there are 170 jurisdictions with some form of inclusionary housing program or policy.

A community may consider inclusionary housing for many reasons. The most common include: (1) high cost housing markets where workers are priced out, (2) a lack of supply to meet the affordable housing demand, and (3) a desire to integrate market rate and affordable housing.

San Jose has a significant need for affordable housing. Inclusionary housing may or may not be a tool that the City wants to employ. However, given the need to plan for the development of 19,000 affordable housing units over the next seven years, as required by the State Regional Housing Needs Allocation, it is important to consider whether this policy can help San Jose meet its needs.

### *Methodology*

The consultant's study began with an examination of the actual cost to build market rate housing in San Jose. The study is based on five different types of housing products typically developed or expected to be developed outside of San Jose's redevelopment areas. These five product types, or prototypes, include: ownership high-rise, ownership townhouses, ownership stacked flats, ownership single-family homes, and rental stacked flat apartments.

In order to obtain budgets and perspectives regarding the costs associated with these developments, the Housing Department invited 16 developers, selected because of recent projects completed in San Jose, to participate in the study. DRA received affirmative responses from 9 developers to participate and held a series of interviews to review their pro formas.

During this time, DRA also worked with the Housing Department, Planning, Building and Code Enforcement and the Redevelopment Agency to agree on assumptions related to: (1) the affordable housing set-aside requirement (the amount of affordable housing that would be

required of a market rate development), and (2) the incentives and alternative compliance options to be considered in order to defray the cost of developing the affordable housing units.

The City decided to model six scenarios for the affordable housing set-aside: three for renter and three for owner. Scenario #1 represents the current affordability requirements in San Jose's Redevelopment Project Areas. These scenarios were selected in response to feedback received from stakeholders and because they offered a wide range of affordability. The following set aside scenarios were modeled in the study and vetted with stakeholders at the January 17, 2008, public meeting.

Rental Scenarios	Total Set-Aside Amount	Income Levels – By Area Median Income (AMI)	Approximate Target Income Ranges for a Family of Four in San Jose
1	20%	<ul style="list-style-type: none"> <li>• 12% at 60% AMI</li> <li>• 8% at 50% of AMI</li> </ul>	\$52,750 - \$63,300
2	15%	<ul style="list-style-type: none"> <li>• 10% at 60% AMI</li> <li>• 5% at 50% AMI</li> </ul>	\$52,750 - \$63,300
3	10%	<ul style="list-style-type: none"> <li>• 5% at 35% AMI</li> <li>• 5% at 50% AMI</li> </ul>	\$36,925 - \$52,750

Owner Scenarios	Total Set-Aside Amount	Income Levels	Approximate Target Income Ranges for a Family of Four in San Jose
1	20%	<ul style="list-style-type: none"> <li>• 120% AMI</li> </ul>	\$126,600
2	15%	<ul style="list-style-type: none"> <li>• 10% at 120% AMI</li> <li>• 5% at 90% AMI</li> </ul>	\$94,950 - \$126,600
3	10%	<ul style="list-style-type: none"> <li>• 5% at 90% AMI</li> <li>• 5% at 80% AMI</li> </ul>	\$84,400 - \$94,950

The developer incentives and alternative compliance options modeled in the study are listed below. Again, these were chosen because they could offer the most flexibility for developers and were typical types of incentives/off-sets offered in other California jurisdictions. Additionally, City staff wanted to ensure that some of the components of the current RdA inclusionary policy were modeled for demonstration purposes.

1. **Design Modifications** – Allowing less expensive interior finishes in the below market units.
2. **Off-Site New Construction** – Allowing the inclusionary requirement to be met by finding another, less expensive location for the below market units.
3. **Off-Site Acquisition/Rehabilitation** - Allowing the inclusionary obligation to be met by purchasing and rehabilitating an existing development for affordable housing occupancy.
4. **Alternative Unit Type** – For single-family or townhomes, allowing a stacked flat product type to meet the inclusionary obligation. Or, allowing developers to build units with more bedrooms, but fewer overall units, in order to meet the obligation.
5. **Density Bonus** – Allowing a developer to achieve higher maximum densities in order to offset the inclusion of the below market rate units.

The final important component of study was the determination of land prices in San Jose. Land prices over the last three to four years have fluctuated wildly throughout the City. Land prices were determined over a three year (for High-Rises) and four-year period. Data was obtained through the "San Jose Residential Land Value Survey" for the years 2003, 2004, 2005, and 2006, in addition to recent land appraisal commissioned by the City's Housing Department or its borrowers. Given the huge variation of market land sales comparables, it was decided that it was best to further breakdown the study to look at the feasibility of inclusionary within low, middle, and high rent or sales prices.

### *Results*

Attachment A provides a summary overview of the findings of the study. More detail about the particular findings can be found in the "Inclusionary Housing Study" on the Department's website. Generally, the results of the study found that for High-Rise, Owner Tomehomes (with offsets), and Owner Single-Family Detached prototypes, all three affordable housing set-aside scenarios are feasible, ensuring an acceptable profit to the developer based on responses provided by developers in interviews. In the case of Owner Stacked Flats, the findings indicate that only in the case of middle and high land prices will this product type work, and for the Renter Stacked Flat product, only high rent properties would be feasible, and only in one of the affordable set-aside scenarios.

### *Additional Discussion*

As the potential for a Citywide policy is discussed going forward, there are a number of issues that will need discussion prior to any recommendation being formulated. These fundamental issues include:

- **Threshold** – At what point would an inclusionary obligation be triggered. For example, for developments over ten units, 20 units, or more?
- **Product Type** – What types of housing should be included in any ordinance? For-Sale, rental, condominium conversions, or substantial rehabilitation?
- **Affordability Set-Aside** – What percentage and at what income level should be required in an ordinance?
- **Term of Affordability** – What is the time period an ordinance should require a unit remain affordable?
- **Applicability** – Should the City adopt a new ordinance Citywide, at what point in the develop process would you grandfather in these new projects?
- **Developer Incentives and Flexibility** – What, if any, offsets or incentives should be considered?

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

It is anticipated that a policy recommendation will be brought forward to the Community and Economic Development Committee and Neighborhood Services and Education Committee in

August/September 2008, with a final recommendation to the City Council in September/October 2008.

### **POLICY ALTERNATIVES**

*Alternative 1: The Mayor and City Council could choose not to accept the report, or request further revisions/additions to the Inclusionary Housing Study.*

**Pros:** This would provide an additional opportunity for the Mayor and City Council to examine other aspects of the inclusionary housing issue or get answers to very specific questions.

**Cons:** This would represent an additional cost and time to the Housing Department that it has not budgeted. It would also add to the complexity of an already lengthy and detailed report.

**Reason for not recommending:** This study was commissioned to cover the general issue of feasibility. There are endless possibilities and scenarios that could be considered or studied. The process used to arrive at this result was an open one; all comments and documentation were taken under consideration, posted and vetted publicly to ensure that all stakeholders could review, ask questions, and provide feedback. The developers themselves provided the data included in the financial analysis, which was incorporated into the formula that determined the results. More study would not result in any different results unless the data initially received was flawed.

*Alternative 2: The Mayor and City Council could chose to direct staff to extend the timeline and provide more public meetings.*

**Pros:** This would allow even more time to conduct public meetings regarding policy development to ensure that the subject is thoroughly considered.

**Cons:** Additional meetings will be an extra workload for staff, and may not necessarily add anything new or different to the policy development discussion.

**Reason for not recommending:** The new, revised timeline should allow for ample opportunity for staff to thoroughly conduct public outreach and arrive at a recommendation by the Fall of 2008.

**PUBLIC OUTREACH/INTEREST**

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

To date, the Housing Department has held a number of public meetings to discuss the study and to educate the public and City Commissions about inclusionary housing.

In addition to the public meetings held on January 17, February 13, and March 26 to discuss the Inclusionary Housing Study with public stakeholders, the Housing Department provided educational presentations to the Housing and Community Development Advisory Commission, the Planning Commission, and the Senior Citizen's Advisory Commission in March and April 2008. Additional meetings are planned, as discussed in this report.

**COORDINATION**

This memorandum was coordinated with the City Attorney's Office, the Department of Planning, Building and Code Enforcement, and the San Jose Redevelopment Agency.

**CEQA**

Not a project.

  
LESEYE KRUTKO  
Director of Housing

Attachment

**SUMMARY CHARTS – INCLUSIONARY HOUSING STUDY FINDINGS**

<b>PROTOTYPE</b>	<b>FEASIBLE WITHOUT OFFSETS</b>	<b>FEASIBLE WITH OFFSETS</b>	<b>INFEASIBLE</b>
Owner 1: High-Rise	<ul style="list-style-type: none"> <li>• Feasible Under All Sales Price Scenarios</li> <li>• Feasible Under All Three Affordable Set-Aside Scenarios</li> </ul>	<ul style="list-style-type: none"> <li>• No offset needed</li> </ul>	N/A
Owner 2: Stacked Flat	<ul style="list-style-type: none"> <li>• Feasible Under Middle and High Sales Price Scenarios</li> <li>• Feasible Under All Three Affordable Set-Aside Scenarios</li> </ul>	<ul style="list-style-type: none"> <li>• No offset needed</li> </ul>	<ul style="list-style-type: none"> <li>• Infeasible Under Low Sales Price.</li> </ul>
Owner 3: Townhomes	<ul style="list-style-type: none"> <li>• Feasible Under Middle and High Sales Price Scenarios</li> <li>• Feasible Under All Three Affordable Set-Aside Scenarios</li> </ul>	<ul style="list-style-type: none"> <li>• Feasible Under Low Sales Price Scenario with Density Bonus, On-Site Alternative Product, or Acq/Rehab Offset</li> </ul>	N/A
Owner 4: Single-Family Detached	<ul style="list-style-type: none"> <li>• Feasible Under All Sales Price Scenarios</li> <li>• Feasible Under All Three Affordable Set-Aside Scenarios</li> </ul>	<ul style="list-style-type: none"> <li>• No offset needed</li> </ul>	N/A
Renter 1: Stacked Flat	N/A	<ul style="list-style-type: none"> <li>• Feasible Under High Rent Price Scenario but only for Affordable Set-Aside Scenarios #1 &amp; #3 with a Density Bonus</li> </ul>	<ul style="list-style-type: none"> <li>• Infeasible Under Low and Middle Rent Price Scenarios.</li> </ul>

**\* CORRESPONDING AFFORDABILITY SET-ASIDES**

<b>Owner Scenarios</b>	<b>Total Set-Aside Amount</b>	<b>Income Levels</b>
1	20%	<ul style="list-style-type: none"> <li>• 120% AMI</li> </ul>
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