



Memorandum

TO: HONORABLE MAYOR, CITY
COUNCIL AND REDEVELOPMENT
AGENCY BOARD

FROM: Debra Figone
Harry S. Mavrogenes

SUBJECT: SEE BELOW

DATE: September 15, 2009

COUNCIL DISTRICT: Citywide
SNI AREA: All

**SUBJECT: AMENDMENT TO REDEVELOPMENT AREA INCLUSIONARY
HOUSING POLICY TO ALLOW FOR A WAIVER OF AFFORDABILITY
REQUIREMENTS FOR THE SALE OF OWNERSHIP UNITS**

RECOMMENDATION

It is recommended that the City Council and the Redevelopment Agency Board adopt resolutions amending the "City of San Jose Policy on Implementation of the Inclusionary Housing Requirement of Health & Safety Code Section 33413(b)(2)" for redevelopment project areas by providing a waiver of the requirement for a very low-, low- or moderate-income restriction on a for-sale unit when the affordable housing price is within 5% of the unrestricted market value of the unit.

OUTCOME

Approval of the recommended action will remove a potential impediment to selling units in for-sale developments located in redevelopment project areas.

BACKGROUND

State law requires that at least 15% of the housing developed in redevelopment project areas established since 1976 be affordable. To comply with this requirement, the City Council and Redevelopment Agency Board jointly adopted the "City of San Jose Policy on Implementation of the Inclusionary Housing Requirement of Health & Safety Code Section 33423(b)(2)" in the 1980s. The Policy was most recently amended on June 19, 2007.

In general, the current Policy requires that developers of housing in redevelopment project areas make a portion of the units in their projects affordable without any financial assistance from the City or the Redevelopment Agency. The Policy provides a number of means for alternatively

complying with the requirement to provide the inclusionary units within the developer's project, including, among others, payment of an in-lieu fee, construction of the inclusionary units off-site, dedication of land, or some combination of the alternative compliance methods.

In for-sale projects, when the developer elects to include the inclusionary units within the project, the requirement is that either 20% of the units must be affordable to low- or moderate-income households or a combination of 9% affordable to low- or moderate-income households and 6% affordable to very low-income households.

ANALYSIS

In for-sale developments, the inclusionary policy requires that the restricted units be priced at an "affordable housing price" for the specified income level and that the restricted units be marketed and sold to households at or below the specified affordable income level. Historically, this has required for-sale developers to price the inclusionary units below the prevailing market-rate price for a similar unit in the same development, the difference being the "developer discount." The City records an affordability restriction on the price-discounted unit as well as a deed of trust securing the amount of the developer discount. That discount forms the basis for an equity share provision under which the homeowner owes the City a share of increased equity should the home be sold to a non-income-qualified buyer prior to the 45-year term of the affordability restriction.

In depressed housing market conditions like those prevailing at the present time, developers are forced to bring housing prices down for all units in order to attract buyers, even to the point that market-rate home prices can approach or even equal the affordable price for such units. As a result, the market is providing affordable for-sale housing units without an affordability restriction being imposed on the developers. This means that:

- Affordable homebuyers can legitimately afford both restricted and unrestricted units.
- The public purpose of requiring for-sale housing affordable to this income level is being satisfied by the unregulated marketplace.
- Affordable buyers are reluctant to purchase homes that are accompanied by an affordability restriction containing an equity share provision if they are eligible to buy the same product without such restrictions. Even though the ultimate effect of these restrictions will be negligible or non-existent depending on the size of the actual developer discount, which is the basis for a future equity-share being owed to the City, these buyers would naturally prefer to buy a similarly priced unrestricted unit with no affordability restriction.
- Consequently, developers are facing difficulties selling the restricted units.
- Even if developers are able to sell these units with affordability restrictions and City deeds of trust, the City will likely expend more money monitoring these units and releasing the restrictions upon resale than will be realized with the negligible or non-existent equity-share payout.

For these reasons, staff agrees with for-sale housing developers that it is appropriate to provide a "pressure-relief valve" to impose less strenuous inclusionary requirements during adverse conditions in the housing market. Therefore, staff is recommending that the pressure-relief valve be added to the existing Inclusionary Housing Policy applicable in redevelopment project areas.

The pressure-relief valve would become operative whenever a developer can demonstrate to the satisfaction of the City Manager and the Executive Director that the Affordable Price of a designated affordable unit is within 5% of the unrestricted market value of such unit. The following provisions shall apply to any waiver of the Inclusionary requirements:

1. The designated affordable unit may be sold at or below the Affordable Price with no requirement that it be sold to a person or family of low or moderate income (as defined in the California Health and Safety Code) ("Affordable Household").
2. The designated affordable unit must be initially occupied by the purchaser.
3. There will be no requirement that any affordability restrictions (or an equity share) be recorded against the designated affordable unit or the project.
4. The waiver shall be valid for six months from the date the application for waiver is approved. If the designated affordable unit is not sold within such six month period, the developer may request an extension of such waiver provided that the developer can demonstrate to the satisfaction of the Executive Director and the City Manager that the applicable unit continues to qualify for the waiver.

In this context, "Affordable Price" is defined as the purchase price to be paid by an Affordable Household to acquire a designated affordable unit as determined under the provisions of the California Health and Safety Code and the City's Inclusionary Policy and the regulations adopted to implement the Policy. A developer may use any reasonable means of demonstrating the market value of a unit, including, but not limited to, an appraisal, comparable sales within the developer's project, or comparable sales of other similar projects located in close proximity to the developer's project.

The pressure-relief valve was originally developed in conjunction with the draft Citywide Inclusionary Housing Ordinance at the suggestion of housing developers. Since consideration of the draft Ordinance has been delayed, due to two recent legal cases involving other cities related to inclusionary housing, staff is proposing the subject amendment to the existing redevelopment-area inclusionary housing policy in order to implement the idea immediately.

Attached is the proposed new language that will be added to the Policy should the action recommended in this memorandum be approved.

EVALUATION AND FOLLOW-UP

Units exempted under the waiver recommended in this memorandum will be included in the Homebuyer Program Summary Statistics section of the quarterly "Report on Activities Undertaken by the Director of Housing and the Director of Finance Under the City Council's Delegation of Authority."

POLICY ALTERNATIVES

To arrive at the recommended proposal, staff also considered the following option:

Alternative #1: *Do not amend the Inclusionary Housing Policy to include a pressure-relief valve.*

Pros: The strict application of the Inclusionary Housing Policy would result in the City obtaining equity-share notes for all inclusionary ownership units within redevelopment project areas.

Cons: Income-qualified buyers are reluctant to purchase restricted units when they qualify to buy unrestricted units, so developers have difficulty selling inclusionary units that are accompanied by an equity-share note when similarly priced units are unencumbered.

**Reason for Not
Recommending:** Adoption of the pressure-relief valve will remove a barrier to improved new home sales in redevelopment project areas, thereby improving the economic vitality of the City.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
- 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.
- 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.

Electronic copies of this memorandum will be: (1) e-mailed to a wide spectrum of market-rate developers, affordable housing advocates and others interested in the inclusionary housing issue; and (2) posted on the City Council Agenda website for the September 29, 2009, meeting.

COORDINATION

Preparation of this memorandum was coordinated with the Housing Department, City Attorney's Office and the General Counsel's Office.

FISCAL/POLICY ALIGNMENT

The proposed amendment to the Inclusionary Housing Policy is consistent with the City's overall housing production objectives and affordable housing program goals.

CEQA

Not a project



DEBRA FIGONE
City Manager



HARRY S. MAVROGENES
Executive Director

Attachment

For questions, please contact Jacky Morales-Ferrand, Assistant Director of Housing,
at 408-535-3855.

New Section VII of the City/Agency Inclusionary Policy

VII Waiver of Inclusionary Requirements.

Notwithstanding anything to the contrary contained herein, the developer of a project containing for-sale units may apply for a waiver of the Inclusionary Requirements contained herein if the developer can demonstrate to the satisfaction of the City Manager and the Executive Director that the Affordable Price (as defined below) of a designated affordable unit is within five percent (5%) of the unrestricted market value of such unit. The following provisions shall apply to any waiver of the Inclusionary Requirements granted hereunder and any developer obtaining a waiver shall comply with such requirements:

1. The designated affordable unit may be sold at or below the Affordable Price with no requirement that it be sold to a person or family of low or moderate income (as defined in the California Health and Safety Code) ("Affordable Household").
2. The designated affordable unit must be initially occupied by the purchaser.
3. There will be no requirement that any affordability restrictions (or an equity share) be recorded against the designated affordable unit or the project.
4. The waiver shall be valid for six (6) months from the date the application for waiver is approved. If the designated affordable unit is not sold within such six (6) month period, the developer may request an extension of such waiver provided that the developer can demonstrate to the satisfaction of the Executive Director and the City Manager that the applicable unit continues to qualify for the waiver in accordance with the requirements of this Section.

For purposes of this section, "Affordable Price" shall be defined as the purchase price to be paid by an Affordable Household to acquire a designated affordable unit as determined under the provisions of the California Health and Safety Code and this Policy and the regulations adopted to implement the Policy. A developer may use any reasonable means of demonstrating the market value of a unit, including, but not limited to, an appraisal, comparable sales within the developer's project, or comparable sales of other similar projects located in close proximity to the developer's project.