COUNCIL AGENDA: 11/17/09
ITEM: 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Krutko

SUBJECT: SEE BELOW

DATE: October 26, 2009

Approved

Date 11-3-09

COUNCIL DISTRICT: City-Wide
SNI AREA: N/A

SUBJECT: ADOPTION OF A CITYWIDE INCLUSIONARY HOUSING ORDINANCE

RECOMMENDATION

It is recommended that the City Council adopt the citywide inclusionary housing ordinance as proposed.

OUTCOME

With the City Council's approval to adopt a citywide ordinance, staff will begin developing guidelines for the administration of the ordinance upon its operative date, which would be the earlier of 6 months after the City has reached 2,500 annual residential permits outside of North San Jose or January 1, 2013.

EXECUTIVE SUMMARY

On December 8, 2008, the City Council provided policy direction for the drafting of an inclusionary housing ordinance. Staff coordinated with the City Attorney's Office, Redevelopment Agency, and the Planning and Building Code Enforcement Department in drafting the ordinance. For certain provisions of the Council direction, staff is recommending alternative language that accomplishes the intent of the Council direction as indicated in the analysis section below. Pursuant to City Council direction in December 2008, the Department held nine additional community and stakeholder meetings to acquaint the community with provisions of the draft ordinance.

BACKGROUND

Purpose

"Inclusionary housing" is a policy that requires that residential developments include a certain number (or percentage) of units affordable to very-low or low-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. The State Regional Housing Needs Allocation indicates that the City should plan for the development of 19,000 affordable housing units over the next seven years. The proposed ordinance would assist the City in reaching the Regional Housing Needs goals in the future.

Public Process and City Council Direction

Given the potential for increasing affordable housing, in June 19, 2007, the City Council adopted the Five-Year Housing Investment Plan, which included an action item for the City to consider the feasibility of a citywide policy for inclusionary housing. Additionally, on December 11, 2007, the City Council held a special study session to discuss inclusionary housing, how it has been used in other jurisdictions, including those in the Bay Area, and the potential benefits and impacts of a City-wide policy including how the policy would help the City meet its regional housing goals.

As a first step in the process, the City Administration worked with a consultant (David Rosen and Associates) in early 2008 on an economic feasibility study related to the potential of a citywide inclusionary policy. This feasibility study was developed with the help of over 700 individuals, affordable housing advocates, developers, and community organizations. The study determined that while the economy was faltering and residential development was at a standstill, with the right developer incentives, inclusionary housing could under better economic circumstances, be economically feasible in most product types. A full copy of this study (along with public comments, agendas, reports, and meeting materials) can be located on the Housing Department's website at http://www.sjhousing.org/policy/inclusionarystudy.html.

The findings of this study were presented to the City Council on June 17, 2008. The City Council directed the Administration to develop a policy, educate the public about its potential impacts, and most importantly, get community and stakeholder feedback prior to bringing a draft policy forward for City Council consideration.

Between June and December 2008, the Housing Department conducted a total of 56 meetings. Three types of forums were held to discuss inclusionary housing programs and components with the public. Two meetings were held with the purpose of educating interested community

members on the issue of inclusionary housing and its impacts. Forty one-on-one meetings were conducted with stakeholders (nonprofit, for-profit, community organizations, affordable housing advocates, labor associations, homebuilders association, and businesses) in order to understand concerns or the positions of these groups. Lastly, 14 community meetings were held throughout the City to give the public an opportunity to discuss and review potential policy options that would be included in a draft ordinance.

At the conclusion of this extensive public outreach, on December 8, 2009, the City Council approved an Inclusionary Housing Policy that included a matrix of key elements for the development of an ordinance. The Mayor and City Council directed staff to return to the City Council in early 2009 with a timeline for the drafting, release, public process, and approval of an inclusionary housing ordinance.

Due to the complexity of drafting such an ordinance, City staff delayed the release of an ordinance in order to ensure proper coordination among the various City departments and Redevelopment Agency and to provide enough time to conduct adequate public outreach.

Once the draft ordinance was released for public review in July 2009, nine public meetings were held between July and October. The purpose of these meetings was to discuss with stakeholders and the public components of the ordinance and the staff's recommended changes to the draft ordinances than what was provided by City Council under the approved policy direction from December 2008.

ANALYSIS

Staff from the Housing Department; Redevelopment Agency; Planning, Building, and Code Enforcement; and the City Attorney's Office have crafted an inclusionary housing ordinance after much time and consideration based on the policy adopted by City Council in December 2008.

The major objectives staff used in drafting an ordinance were: consistency, fairness, feasibility of implementation, achieving the direction provided by City Council, while also meeting the objectives of creating integrated affordable housing in our community. However, after working for several months in partnership with our City partners, it became clear that we could not meet these objectives in several areas of an ordinance. In some cases the provisions approved by City Council may not lawfully or administratively lead to feasible implementation or an effective program. Therefore, staff is proposing the following changes that comport with the intent of the direction provided by City Council and provides for consistent and feasible implementation.

The detailed matrix below provides a basic overview of the central provisions of the ordinance directed to be included by the City Council on December 8, 2008. As noted above, there are several specific areas where staff is recommending that the City Council make changes to the previous policy direction. These areas are highlighted below. The following is a discussion of the staff recommended changes and includes the rationale for those changes. Where the staff recommendation is blank, no change to Council direction is recommended.

Issue	Council Direction	Staff Recommendation
Applicability refers to where the ordinance will apply in the City of San Jose. Section 5.08.400	**Geographic** – In RdA areas, 20% of the units will be affordable. In Low income areas outside of RdA areas, 15% will be affordable. In all other areas, the percent set-aside requirements in the next section will apply. **Building Types** – Ordinance requirements will apply to new construction and conversion of non-residential development to residential development (but not to acquisition/ rehabilitation).	Citywide requirement: • Onsite:15% • Offsite: 20%
	Rationale: For ease and consistency of implementation and certainty to the development community, but also consistent with Council's intent, staff recommends applying the lower threshold of 15% affordable units citywide when the affordable units are constructed on the same site as the market rate units, and 20% if the affordable units are provided off-site. Staff believes this would provide certainty and less confusion regarding applicability of the ordinance and will further encourage the units to be integrated on-site, which is one of the City's policy goals. The Council direction to implement different set-aside requirements in RdA verses the rest of the City would have negatively impacted housing development in the RdA. By imposing the same requirement in all areas of the City, affordable housing will be constructed in redevelopment project areas to the same degree as other areas of the City, rather than less in redevelopment areas because of greater affordability requirements.	
Percent Inclusionary and Income Targeting Requirement refers to the percentage of housing units that developers will construct, and sell or rent, as affordable under the ordinance. Targeting requirements refers to the income categories that the inclusionary units will target under the ordinance (i.e. low-income is 60% area median income) Section 5.08.400 & 5.08.510	**Rental**—Developer chooses one of two options: Onsite: 15% of total units • 6% of total units affordable to very low-income households; and • 9% of total units affordable to Low-Income households. Offsite: 20% of total units • 12% affordable to Low-Income households. • 8% affordable to Very Low-Income households. **For-Sale**—Developer chooses one of two options: Onsite: 15% of total units • 15% Moderate-Income households Offsite: 20% of total units (rental) • 20% Moderate-Income households **or** • 8% Very Low-Income and 12% Low-Income households.	Changes have been recommended under the rental component of the ordinance to comport with recent case law and to expand the definitions of the required income categories: **Rental** - Staff also recommends that Council include the requirements for rental projects to provide inclusionary housing in the ordinance with the specific proviso in the ordinance that if the decision in *Palmer/Sixth Street Properties v. City of Los Angeles* (2009) 175 Cal.App.4th 1396 is overturned, disproved or there is legislation that effectively invalidates the *Palmer* holding, the requirement for rental inclusionary housing will take effect (See discussion of case in *Rationale* section below). Staff has provided specific income targets for the rental component, but the mix of affordability remains the same as the Council's direction. Additionally, staff expanded the definition of moderate income. The income categories are:

Issue	Council Direction	Staff Recommendation
		• Very Low Income (50% AMI) • Low Income (60% AMI) • Moderate Income (80% AMI) **For Sale** – Staff has provided income definitions for the for-sale requirement. The specific income categories listed below: • Sales price set at 110% AMI, eligible households up to 120% AMI (Moderate Income). Staff clarified that for-sale developers will have the alternative compliance option to build rental housing off-site. The income definitions for the off-site compliance option for rental housing are: • Very Low Income (50% AMI) • Low Income (60% AMI)

Rationale:

Rental: At the time the Council considered its direction to staff regarding this ordinance, Council and staff recommended that the ordinance include a requirement for rental housing projects to include affordable housing. Since that time, on July 22, 2009, the 2nd District Court of Appeal decided a case called *Palmer/Sixth Street Properties v. City of Los Angeles* (2009) 175 Cal.App.4th 1396 which, although not legally binding upon the City of San Jose, calls into question the validity of inclusionary housing mandates upon rental housing projects. The case stems from a challenge by a rental housing developer to the imposition of an inclusionary housing requirement within a Specific Plan area in the City of Los Angeles.

In *Palmer*, the developer sued the City of Los Angeles on the grounds that the Specific Plan's affordable housing requirement violates the Costa-Hawkins Rental Housing Act (Civ. Code, § 1954.50 *et seq.*). The Costa-Hawkins Act, which was enacted by the Legislature in August 1995, establishes "vacancy decontrol" by declaring that, "[n]otwithstanding any other provision of law," all residential landlords may, with limited exceptions, establish the initial rental rate for a dwelling unit upon any change in tenancy. The Costa-Hawkins Act limits the ability of local laws to regulate rents over time. The only exceptions to Costa-Hawkins are when the developer requests a density bonus from the local agency in exchange for the provision of affordable housing or the developer voluntarily agrees to provide housing at restricted rents in exchange for monetary or other consideration from the local agency.

Although the *Palmer* case is not binding upon the City of San Jose, staff recommends that Council include the requirements for rental projects to provide inclusionary housing in the ordinance with the specific proviso in the ordinance that if the *Palmer* decision is overturned, disproved or there is legislation that effectively invalidates the *Palmer* holding, the requirement for rental inclusionary housing will take effect. Currently, the City of Los Angeles has petitioned the California Supreme Court to review the appellate court decision, but it is yet undetermined whether the Supreme Court will hear the appeal. Staff also recommends the proposed ordinance include an on-site rental inclusionary housing option that for-sale housing developers may select in lieu of providing for sale inclusionary units.

Also, in order to provide more clarity in the rental provisions of the ordinance, staff added definitions of the income targeting. First, in the case of meeting the rental inclusionary on-site obligation, staff suggests changing the 9% low-income units to moderate units not to exceed

Issue	Council Direction	Staff Recommendation
	80% of area median income. This provides an incentive to developers to integrate the affordable units on-site, which is a goal. Last, a definition was provided in the ordinance for the (rental) very-low and low-income units as not to exceed 50% and 60% of area median income (AMI), respectively. These changes would take effect if the rental provision became effective as explained above. **For Sale**: The definition for for-sale moderate was defined as a unit priced to households at 110% of the AMI but could be sold to households earning no more than 120% of the AMI. Staff is recommending this provision in order to be consistent with State Redevelopment Law. Staff is recommending an additional off-site compliance option for for-sale housing that is consistent with the rental alternative outlined by the City Council.	
Partial unit refers to a situation where the percent aside requirement equals a non-whole number.	When an inclusionary obligation results in a fractional unit greater than 0.5, the obligation will be rounded up. The developer can choose to provide the unit or pay the pro rata in-lieu fee for the fractional unit.	
Threshold is the number of units that a project must hold to fall under the jurisdiction of the inclusionary ordinance. Section 5.08.330.B	Ordinance requirements will apply to developments with 20 or more units.	
Term of Affordability is the number of years an affordable unit must remain affordable under this ordinance. Section 5.08.600.B	**Rental** - Inclusionary units must remain affordable for 55 years. **Owner** - Inclusionary units must remain affordable for 45 years (the restriction can be removed with an equity-share buyout at the time of re-sale).	
Operative Date of Ordinance is the date the ordinance will become operative or go into effect Section 5.08.300	Ordinance becomes operative following a 12-month period in which building permits for 2,500 units have been issues, as long as 1,250 or more of the units have been issued outside of North San Jose. **OR** The ordinance will become operative no later than January 1, 2013 if the City Council passes a motion at least a month prior to that date authorizing the ordinance to become effective.	Six months after the first 12 month consecutive period in which 2,500 residential building permits have been issued by the City, of which no more than 1,250 are for Dwelling Units in the North San José Development Policy Area; **OR** January 1, 2013.

Issue	Council Direction	Staff Recommendation
	Rationale: In the public meetings held regarding the draft ordinance in July and September 2009, staff heard comments that developers would need more notice than the first day of the month following the issuance of 2,500 permits. Therefore, staff is recommending that Section 5.08.300.A of the proposed ordinance be changed to make the building permit related operative date: "*6 months after the first day of the month following the first 12-month consecutive period prior to January 1, 2013 in which two thousand five hundred (2,500) residential units have been issued...*" The second change staff recommends is removing language in Section 5.08.300.B of the proposed ordinance that would require the Administration to return to City Council for further approval of the ordinance to become effective on January 1, 2013 at the latest. Once an ordinance is approved by City Council, it takes effect within 30 days of adoption and is not required to be re-approved or ratified at a later date. Staff is concerned that this last provision will create uncertainty in the market and planning process. Rather, staff suggests that it will distribute an Information Memorandum to the Mayor and City Council not less than six months from the January 1, 2013 operative date of the ordinance (in the event that the ordinance has not already become operable because the City has issued more than 2,500 residential building permits under that option), and will publicly post a notice to the development community. This should achieve the objective of informing the public and City Council of the upcoming operative date of the ordinance and will provide the Council with the opportunity to reconsider the ordinance if desirable at that time.	
Exemptions are situations in which developments will not be required to comply with the ordinance. Section 5.08.330	Developers meeting the following requirements will be exempt from the requirements of the ordinance: i.) All Units: Within 6 months of the operative date of the ordinance, the developer submits a signed, application, pays all required fees, and submits data required on a planning permit check list that was in place at time of ordinance adoption, for a planning permit (General Plan Amendment, Zone Change, CUP, site development, or PO permit) and environmental clearance pursuant to the provisions of the Zoning Ordinance and the Environmental Clearance Ordinance, and ii.) Projects 749 units or less: Within 24 months after the operative date of the ordinance, the developer receives an approved planning permit. Within 30 months after the operative date of the ordinance the developer receives an approved building permit. **OR** iii.) Projects of 750 units or greater: Within 30 months after the operative date of the ordinance, the developer receives an approved planning permit. Within 40 months after the operative date of the ordinance, the developer receives an approved building permit. **AND** iv.) Projects requiring phasing: The builder shall have 24 months from the pulling of the first building permit to pull the permits for the final	Residential developments which are not located, wholly or in part, within a Redevelopment Project Area that have obtained prior to the operative date one of the following: an approved (1) Development Agreement, (2) Disposition and Development Agreement, or (3) Planning Permit for which any and all appeals have been exhausted pursuant to Title 20. The Residential Development in a Planned Community ("PC"), as set forth in the General Plan as of the adoption date of this ordinance, for which a Specific Plan was originally adopted no later than 1992 such that the PC requires the construction of new on-site and off-site infrastructure on an incremental basis in conjunction with the Residential Development, provided that, unless otherwise vested, prior to the operative date of this ordinance, each of following apply: ▪ One or more phases of the Residential Development have been completed in conformance with the Specific Plan. ▪ The completed phase or phases of the Residential Development have constructed

Issue	Council Direction	Staff Recommendation
	phase. These times will be extended by the amount of time necessary to resolve delays imposed by city policy or regulations as well as non-city regulations If building permits are allowed to expire without construction of the project, the development will no longer be exempt from the ordinance.	some, but not all, of the new infrastructure improvements consistent with the Specific Plan for the PC. ▪ At minimum, one undeveloped portion of the site within the Specific Plan must obtain an approved building permit within forty (40) months of the operative date of this ordinance.
	Rationale: Staff is concerned about the complexity of the requirements and the ability and time required for staff to track and monitor projects in accordance with these requirements. Staff recommends that it will still meet the Council's objective of providing an exemption for those projects that are well underway upon the operative date of the ordinance, but that more clarity and ease of administration can be accomplished with some changes to the Council direction. Staff recommends changing the exemption language in Section 3.04.300.F of the ordinance language so that developers meeting the following requirements will be exempt from the requirements of the ordinance if, prior to the operative date, the development has one of the above requirements. In addition, staff received feedback from the development community that the large scale development exception had been removed. As a result, staff has added an additional exemption for large scale developments which are part of a Residential Development and have been completed with a Specific Plan adopted no later than 1992 can receive an exemption if a building permit is pulled within 40 months of the operative date. The majority property owner in the Communication Hill Specific Plan area contends that any deadline for obtaining the first building permit may well inhibit any prospective developers of the remaining 2,500+ units from developing because they must finance in excess of $200 million of extra ordinary infrastructure costs.	
Limited Waiver Section 5.08.400.B	When the gap between the market price and the calculated affordable price for homeownership units is within 5%, the developer is entitled to relief from his/her inclusionary obligation upon certification to the Housing Department of market prices in his/her development. The following provisions constitute the form of that partial relief: 1. The home must be sold at the restricted price 2. No equity share provision will be required. 3. The unit must be owner-occupied. 4. No income verification of the buyer will be required. 5. Developer must re-certify that the relief is needed every six months.	

Incentives for On-site Inclusionary Units

Issue	Ordinance	Staff Recommendations
Density Bonus Section 5.08.440.A.1	The developer that provides the affordable units on-site may receive a density bonus equal to the percentage inclusionary housing required by the Ordinance, provided it is consistent with State density bonus law.	
Parking Space Requirement for Affordable Units allows developer to decrease the number of parking spaces required in developments with affordable units on-site. Section 5.08.440.A.2	With the approval of the Planning Department Director, a development that provides the affordable units on-site may be granted reduced parking requirements for the affordable units.	
Reduction in Minimum Setback Requirements Section 5.08.440.A.3	With the approval of the Planning Department Director, a development that provides the affordable units on-site may be granted altered setback requirements for the affordable units.	
Alternative Unit Type allows developers who build the affordable units onsite to build alternative types of units (i.e. townhomes) Section 5.08.440.A.4	Provided the affordable units are provided on-site and have the same bedroom count distribution as the market rate units, developers may provide affordable units that are a different product type than the development's market rate units.	
Alternative Interior Design Standards allow developers who build the affordable units onsite to utilize alternative types of interior finishes within the affordable units. Section 5.08.440.A.5	Provided the affordable units are provided on-site and have the same bedroom count distribution as the market rate units, the affordable units may use different interior design, appliances and materials than the market rate units.	
Expedited Review allows developers who build the affordable units on-site to receive expedited review from	A development that provides the affordable units on-site will be offered an expedited review process.	Due to the current financial situation, the Planning Department does not have the available financial resources to offer this off-set at this time.

Issue	Ordinance	Staff Recommendations
the City during the planning process. Section 5.08.440.A.6	**Rationale:** Staff recommends deleting this incentive, but retain the seven other incentives for on-site development. After many discussions with the Department of Planning, Building, and Code Enforcement current staffing levels and budget cannot support this effort.	
City Process Assistance allows developers who build the affordable units on-site to receive City assistance (such as development review and technical assistance)	A development that provides the affordable units on-site will be offered technical assistance, including assistance with the development review process, financing alternatives, and selling/renting the affordable units to qualified buyers/tenants.	
Financial Subsidies Section 5.08.44.A.8	The developer may apply for financial subsidies for the affordable units from federal and state funding sources. The developer may apply for City financial subsidy if demonstrated that more units or deeper affordability will be achieved than is required under the Ordinance.	

Alternative Developer Compliance Options

Issue	Council Direction	Staff Recommendations
Off-Site Construction is an alternative compliance option that allows developers to build the affordable housing units off-site from the market rate development. Section 5.08.510	Off site construction of affordable units may be in any planning area as long as the project is compatible with the city's affordable housing dispersion policies. - The project must meet City quality standards. - Units developed in RdA area must provide off-site construction units in the same or another RdA area.	

Issue	Council Direction	Staff Recommendations
In Lieu Fee is an alternative compliance option that allows developers to pay a fee to the City in-lieu of building the affordable housing units. Section 5.08.520	▪ The per unit in-lieu fee amount will equal the amount stated in the staff recommendation except that fees for rentals, condos, and townhouses will be set at 15% less than the staff recommendation. The fee level will be reviewed on a biannual basis and readjusted by Council if a disproportionate number of projects pay fees rather than construct inclusionary units. • Fees shall be collected immediately prior to the issuance of certificates of occupancy; failure to pay fees shall delay the issuance of certificates. In order to ensure payment of the fees, the City will impose an affordability restriction/ affordable housing plan. • Rental Housing-- The per unit in-lieu fee amount will equal the average per unit City subsidy required for affordable new construction rental housing development in the prior year. • Ownership Housing—The per unit in-lieu fee amount will equal the "affordability gap," or the gap between the cost of constructing the unit and the revenue collected from selling the unit at the affordable sales price. • High-Rise Housing—The per unit in-lieu fee for high-rise housing in the downtown will be reduced consistent with current or future Council direction • The City will use the in-lieu fees to provide funding for: 1. at least 30% of the funds collected will be used to develop housing for households earning at or below 30% of the AMI; • Cover reasonable administrative or related expenses associated with the administration of the ordinance, including funding for staff to implement expedited permit review.	Rental Residential Development: • The in lieu fee for each Inclusionary Unit shall be no greater than the average City subsidy required for new construction of a rental residential unit at an Affordable Housing Cost for a Lower Income Household, with changes in the fee based upon commitments of City affordable housing development funding in the prior twelve (12) month reporting period specified in the Affordable Housing Guidelines. For-Sale Residential Development: • The in-lieu fee for each Inclusionary Unit in for-sale Residential Developments shall be no greater than the difference between the median sales price of all attached ownership units Citywide in the prior thirty-six (36) month reporting period specified in the Affordable Housing Guidelines and the Affordable Housing Cost for the average-sized attached for-sale Inclusionary Unit based on the Affordable Housing Cost for a Moderate Income Household. Attachment D outlines the methodology utilizes to calculate the in-lieu fee.

Issue	Council Direction	Staff Recommendations
	Rationale: The in-lieu fee methodology must be legally justifiable, subject to ease and consistency of administration, and allow for periodic adjustment as may be necessary to support the goals of the inclusionary program. Staff performed an in-depth financial assessment to justify a reasonable in-lieu fee methodology. This analysis looked at the cost of developing market rate housing compared to the per unit subsidy that the housing department provides to affordable housing developments. Therefore, the ordinance was drafted with the following provisions related to for-sale and rental development in lieu fee methodology. Applicable to for-sale residential development, the in lieu fee methodology for each inclusionary unit is be no greater than the difference between the median sales price of a Market Rate Unit and the Affordable Housing Cost for an Inclusionary Unit based upon the Affordable Housing Cost for a Moderate Income Household. For rental residential development, the in lieu fee methodology for each inclusionary unit is to be no greater than the average City subsidy required for new construction of a rental residential unit at an Affordable Housing Cost for a Lower Income Household, with changes in the fee based upon commitments of City affordable housing development funding in the prior twelve (12) month reporting period specified in the Affordable Housing Guidelines. This provision will only become operative if the rental residential inclusionary housing requirement is operative as discussed in Section 2 above. Related to in lieu fees, but for information purposes only, there is a recent case decided on January 30, 2009 by the Fifth District Court of Appeal, *Building Industry Ass'n of Central California v. City of Patterson* (2009) 171 Cal.App.4th 886, where an affordable housing in lieu fee was invalidated as applied to a residential development project through an existing development agreement that required the fee to be reasonably justified. In *Patterson*, the reason the fee was invalidated as applied to this particular project was that the City had merely divided its projected cost of developing the City's regional share of affordable housing by the total number of projected market rate housing units in the City, raising the fee from $736 to $20,946 per unit. In San Jose, the developer's option to pay a fee in the proposed ordinance and the methodology therefore does not take the *Patterson* approach, nor does it affect any existing development rights conferred by development agreements, so it is unnecessary to modify the proposed ordinance as a result of the *Patterson* case. Finally, staff is not recommending a 15% reduction in fees for rentals and condominiums. This provision would under fund the affordable housing program and there is no secondary source with which the Department can utilize to backfill these needed funds.	
Land Dedication is an alternative compliance option that allows developers to donate land to the City in-lieu of building the affordable housing units. Section 5.08.530	The developer may provide developable land instead of providing units on-site if the site is suitable for residential development and the land value is sufficient to meet the inclusionary requirement without additional City funding.	

Issue	Council Direction	Staff Recommendations
Credit Trading or Credit Transfer – General is an alternative compliance option that allows developers to transfer or trade inclusionary unit credits to another developer in-lieu of building the affordable housing units. Section 5.08.540	Developers may transfer and/or trade inclusionary unit credits to pool together and build larger affordable projects off-site.	
HUD Restricted Preservation alternative compliance option allows owners of HUD multi-family buildings to receive an inclusionary housing unit credit for a certain number of existing HUD-restricted units. Section 5.08.560	An owner of a multi-family project that is subject to a HUD restriction that expires after the date of the ordinance takes effect can receive **a credit for one future inclusionary unit** for **every five HUD contract units** that the owner agrees to maintain at affordable levels for as long as HUD provides subsidies, but no less than **five years**. This benefit is not transferable from the owner to another developer.	For every **two units HUD contract units**, the owner will receive **one future inclusionary unit credit**. Units must remain affordable for **40 years**.
	Rationale: In drafting the ordinance, a concern arose that the language requiring a 4:1 or 5:1 ratio for rehabilitation of market-rate or provision of HUD-restricted units as affordable units may not have a rational relationship to the basic inclusionary requirement nor to Council's expressed desire that the in lieu options have some equivalency in cost so that one option will not be simpler or necessarily more desirable than another. Upon analysis, staff found that a more cost equivalent approach is a ratio of two acquisition/ rehabilitated units to one new inclusionary unit and with some other additional requirements on the nature of the rehabilitation work. Therefore, staff recommends reducing the amount of the inclusionary developer in lieu option for acquisition/rehabilitation restricted units to require two acquisition/rehabilitated inclusionary units in lieu of one on-site inclusionary rate unit. Similarly, staff also recommends a 2:1 ratio be required for the developer option of providing two HUD-restricted affordable units in lieu of each inclusionary unit that would otherwise be required on-site. Last, staff recommends that a minimum affordability restriction be placed on these units of not less than 40 years so, in particular, that the use of such existing units as inclusionary units continues for the same length of time as all other required inclusionary units pursuant to the ordinance. The goal of inclusionary is to have affordable units continue to count toward the City's regional housing needs allocation obligation for the maximum period authorized by law. Under Housing Element law, in order to count a preserved affordable unit, it must be affordable for period not less than 40 years.	

Issue	Council Direction	Staff Recommendations
Acquisition and Rehabilitation is an alternative compliance option that allows developers to acquire and rehabilitated exiting blighted units. The rehabbed units will be affordable. Section 5.08.550	The developer may comply with the inclusionary obligation by acquiring and rehabilitating market-rate apartment units and converting them to affordable units. Developer must meet requirements that are stated in the administrative rules and regulations for the timing of commencement of rehabilitation work and completion of the rehabilitated units. Developers who acquire and rehabilitate existing housing units and market the units with deeded affordability restrictions shall receive **one future inclusionary credit for every four units** rehabilitated. There was no direction on the term of affordability for acquisition and rehabilitated units.	For every **two units, developer will receive one future inclusionary unit credit**. Units must remain affordable for **55 years**.
	Rationale: Same as rationale above for HUD restricted units.	
Combination Section 5.08.570	The developer may comply by combining alternative compliance options.	

EVALUATION AND FOLLOW-UP

If the City Council adopts the ordinance, the City Administration will alert the City Council via an Information Memorandum three months prior to the ordinance becoming operative the earlier of the City reaching 2,500 building permits or January 1, 2013.

POLICY ALTERNATIVES

Alternative #1: Do not adopt the inclusionary housing ordinance

Pros: No administrative efforts

Cons: Once the market recovers, there will be an opportunity lost to provide a sustainable program to create more affordable housing.

Reason for not recommending: City staff has worked with stakeholders and the community for two years on the development of a fair and balanced ordinance. The draft ordinance represents the need and importance of providing affordable housing in our community, includes provisions that are sensitive to the recovery of the housing market, and provides a great deal of incentives to developers to make it feasible. To stop now would represent a lost opportunity for more affordable housing.

Alternative #2: Do not accept the staff recommended changes in the draft ordinance

Pros: This would provide City Council more opportunity to make changes and suggest improvements or provide direction to staff to adopted the provisions from December 2008.

Cons: May remove some significant concessions made to the development community and flexibility in the administration of the program. Also, this alternative will cost additional staff time and funding.

Reason for not recommending: City staff and stakeholders have spent many hours crafting and revising the draft ordinance in order to meet the major objectives of providing consistency, fairness, feasibility of implementation, while meeting City Council expectations. In most cases, the changes suggested by staff were made in response to concerns raised by the public and development community in order to provide more consistency and or flexibility to developers to meet the requirements of the ordinance or to provide a rationale basis for the requirement.

PUBLIC OUTREACH/INTEREST

☐ **Criteria 1**: Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☑ **Criteria 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)**

☐ **Criteria 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)**

Over the course of the last two years, the City Administration has conducted extensive public outreach (over 70 meetings) through every phase of the policy development process. Since the City Council adopted the policy (December 2008) and the City released the draft ordinance in July 2009, the Administration has held 14 public meetings with the public and stakeholders to vet the draft ordinance. City staff received great feedback and as a result incorporated many of the suggestions received. Please refer to Attachment A for a list of these comments. Additionally, Attachment B outlines the public meeting schedule completed to date as part of the public outreach process.

COORDINATION

Preparation of this report has been coordinated with the San Jose Redevelopment Agency, Department of Planning, Building and Code Enforcement, and the City Attorney's Office. This recommendation aligns with the Five-Year Housing Implementation Plan adopted by City Council in 2007 and the Inclusionary Housing Policy adopted by the City Council in December 2008.

CEQA

Resolution # 65459, PP08-258.

LESLYE KRUTKO
Director of Housing

For questions please contact Leslye Krutko, Director of Housing at (408) 535-3851

Attachments (4)

ATTACHMENT A

COMMENTS RECEIVED DURING THE PUBLIC OUTREACH PROCESS: JULY 2009 – SEPTEMBER 2009

Issue/Option	Positive Comments/Suggestions Received	Negative Comments/Concerns Expressed	General Comments
General Comments	• Add an incentive for ELI housing. • The City needs the flexibility to put money where the need is. • Five years from the operative date the housing department should report on the results. • I appreciate that Very Low-Income is targeted in the ordinance. • I strongly support the date certain approach.	• The ordinance omits housing for ELI, which has the greatest demand for housing in the City.	• The City Council stated that 30% of in-lieu fees would go toward the development of ELI housing. • How much ELI housing do you think will be built under inclusionary? • ELI is missing from the restrictions of the affordable housing fund. • The shared appreciation payment appears useful. • The density bonus does not apply if developers use other off-sets. • Can you include "functional equivalent" in the definition section?
Operative Date	• None	• The language in the operative date section should be simplified. • The City should not give developers so much time before the ordinance goes into affect. • It seems the City will be missing out on a lot of opportunity for affordable units. • Six months seems like too long, I think 30 days would be more appropriate. • The City should provide ample time for developers to be prepared for the inclusionary ordinance.	• Is there no 6 month date before the ordinance goes into effect? • The City should warn developers that the ordinance is going into effect. • This City should provide information between the trigger and operative date.

Issue/Option	Positive Comments/Suggestions Received	Negative Comments/Concerns Expressed	General Comments
Exemptions	• None	• How does this relate to a "specific plan zone" such as Communications Hill?	• It appears that all approved projects should be exempt up to the operative date.
Preservation	• None	• None	• Need to add council's direction on the preservation issue into the ordinance, it is currently not included.
In-lieu fee	• These models seem rational based on what the City needs to provide if the developer doesn't build it.	• The in-lieu fee should include the cost of the development. • If the in-lieu fee is zero, will the pressure valve kick in (not conditional as currently written)? • The in-lieu fee doesn't allow developers to plan for the unexpected costs.	• The "average city subsidy" includes State and federal monies. • Please clarify the difference between "no greater than" as oppose to "equal to." • The in-lieu fee is separate for condos, townhomes, and single-family homes. • Please describe the financial components of the rental in-lieu. • What will the fee be? • The Housing Department should use a time-series forecasting method to determine the in-lieu fee/cost of replacing an affordable limit. • Most of the monies from the inclusionary ordinance in-lieu fee should go to ELI.

Issue/Option	Positive Comments/Suggestions Received	Negative Comments/Concerns Expressed	General Comments
Acquisition/ Rehabilitation	• The change in the term of affordability will keep units affordable for a longer period of time.	• The original ratio for acquisition/rehabilitation units was four to one. • I am concerned about the change in the ratio to 2:1.	• The term of affordability was increased to fifty-five years.
Pipeline	• Planning permits are issued bi-monthly and building permits should be easily tracked.	• The development time period was shortened. This raises concerns for developers. • The ordinance does not provide enough advanced notice before it goes into effect. • Under this draft, developers are losing three months from the Council's direction. • Projects in the City are in jeopardy because of the bad economy. The City Council was trying to address these concerns. • Projects of 750 or more are difficult to build in San Jose. • This ordinance provides an inadequate amount of time. • Developing large projects and obtaining PDO permits can be a long and extended process in the City. • Perhaps multi-phase projects should be excluded from the ordinance.	• Please provide a definition of a planning permit in this ordinance. • The ordinance should apply to multi-phase projects. • What happens if you are building three towers, build tower one and come back and pull second permit for building two—will IZ apply in the second tower? • Suggested that the Planning Department has the capacity to run the necessary reports to determine the City Council's version of allowing exceptions for pipeline projects.

ATTACHMENT A

Issue/Option	Positive Comments/Suggestions Received	Negative Comments/Concerns Expressed	General Comments
Legal Issues	• Do not change course of the ordinance on the Palmer case, please keep the rental component in.	• None	• The City of Patterson case should be considered in the drafting of this ordinance. • The Legislature will take action on the Palmer case. • The relationship to market rate housing needs to be clear.

ATTACHMENT B

PUBLIC MEETING SCHEDULE– INCLUSIONARY HOUSING ORDINANCE

Topic	Attendees	Meeting Dates
Economic Feasibility Study – David Rosen & Associates	Stakeholders and Community Members	• December 11, 2007 – Special Study Session • January 17, 2008 - City Hall • February 13, 2008 – Northside Community Center • March 26, 2008 – City Hall • June 17, 2008 - City Council Meeting
Educational forum – What is inclusionary?	Community Members	• May 29, 2008 – Dr. Roberto Cruz Alum Rock Library • June 18, 2008 – West Valley Branch Library
Policy Components of Inclusionary Housing	Stakeholders and Community Members	• September 23, 2008 – Willow Glen Senior Center • September 25, 2008 – City Hall • October 6, 2009 – City Hall • October 23, 2008 – City Hall
Open forum on ways to finance and produce affordable housing	Stakeholders and Community Members	• October 14, 2008 - City Hall
One-on-One Meetings	Various Stakeholders (including **but not limited to**: non-profit and for-profit developers, community organizations, affordable housing advocates, labor associations, homebuilders association, Chamber of Commerce, California Apartment Association)	• Forty meetings held between August 2008 and November 2008.
Discuss of Policy Components and Draft Proposed Policy of Inclusionary Housing Ordinance	Community Members	• November 3, 2008 – Willow Glen Branch Library • November 6, 2008 – Edenvale Branch Library • November 10, 2008 – City Hall • November 10, 2008 - Special

		City Council Meeting • November 12, 2008 – Berryessa Branch Library • November 17, 2008 – City Hall • November 20, 2008 – Yo-Ai Kai Community Center • December 2, 2008 – Tully Branch Library • December 3, 2008 – Berryessa Community Center – Vietnamese American Community
Draft Inclusionary Housing Ordinance	Community Members	• July 21, 2009 – Berryessa Community Library • July 23, 2009 – Tully Community Library • September 8, 2009 – Willows Senior Center • September 22, 2009 – Southside Community Center • September 23, 2009 – City Hall • September 24, 2009 – West Valley Branch Library
Draft Inclusionary Housing Ordinance	Stakeholders	• July 16, 2009 – City Hall • July 20, 2009 – City Hall • September 17, 2009 – City Hall

ATTACHMENT C

INCOME CATEGORIES

INCOME CATEGORY	*Household Size* 1	2	3	4
Very-Low (31-50%) • *Rental Only* • Minimum wage workers in food service, retail and support services. • Security guard • Janitor • Bank teller • Paralegal	$37,150	$42,450	$47,750	$53,050
Low (51-79%) • Dental Assistant • Science Teacher • Librarian • Plumber	$59,400	$67,900	$76,400	$84,900
Median (80-119%) • Computer analyst • Engineer • Loan Officer • Insurance Agent	$73,900	$84,400	$95,000	$105,500
Moderate (120% +) • Administrative Service Manager • Education Administrator • Budget Analyst • Environmental Scientist • Healthcare Professional	$88,600	$101,300	$113,900	$126,600

**Employment incomes provided by the California Employment Development Department*

City of San Jose
Department of Housing
October 26, 2009

ATTACHMENT D

INCLUSIONARY IN-LIEU FEES

The In-Lieu Fee is but one of several options a developer can choose from to satisfy a development's inclusionary housing obligation.

Were the ordinance operative in 2009, the following in-lieu fees would apply:

Rental Housing Developments

The in-lieu fee is based on the average per-unit City funding commitment approved for affordable housing projects in the 12-month period from April 1, 2008 through March 31, 2009.

Date	Project	City Subsidy	No. of Units
6/24/08	Cornerstone	$6,300,000	52
9/30/08	McCreery Courtyards	$7,900,000	92
12/9/08	90 Archer Street	$4,580,000	41
3/18/09	Kings Crossing	$10,565,700	92
	TOTALS	**$29,345,700**	**277**

Dividing the total amount of City subsidies by the total number of units yields an average per-unit funding commitment of $105,941, which, when rounded to the nearest one-hundred dollars, would result in an in-lieu fee of **$106,000**.

Ownership Housing Developments

The in-lieu fee for most development is based on the difference, rounded to the nearest one-hundred dollars, between:

- An affordable housing price for a moderate-income household of 2.5 persons for an attached product (based on an assumed average of 1.5 bedrooms);

  and

- The median sales price for all attached units in San Jose in the 36-month period from April 1, 2006 through March 31, 2009.

Median of 3 Years of Home Sales	$485,000
Affordable Housing Price	$363,006
Difference	$121,994
Rounded Difference = **In-Lieu Fee**	**$122,000**

Consistent with the current City/Redevelopment Agency Inclusionary Housing Policy for redevelopment project areas, the in-lieu fee for the first 2,500 units in high-rise developments in the Downtown area is recommended to be 50% of the Citywide rate, or **$61,000**.