



Memorandum

TO: HONORABLE MAYOR, CITY
COUNCIL AND REDEVELOPMENT
AGENCY BOARD

FROM: Debra Figone
Harry S. Mavrogenes

SUBJECT: SEE BELOW

DATE: October 12, 2010

**SUBJECT: INCLUSIONARY HOUSING REQUIREMENTS FOR NEW RENTAL
HOUSING DEVELOPMENTS MEETING CERTAIN DEVELOPMENT
TIMELINES**

RECOMMENDATION

It is recommended that the City Council and the Redevelopment Agency Board adopt resolutions:

1. Approving an amendment to the joint City/Agency Inclusionary Housing Policy, applicable in Redevelopment Project Areas, that allows for the execution and recordation of a Satisfaction Agreement evidencing satisfaction of the inclusionary housing requirements for rental housing projects, including multi-phase projects, during the suspension of such requirements under the Policy, provided that the specific project meets specified criteria contained in the amendment to the Policy, including accelerated development timelines.
2. Authorizing the Director of Housing and the Executive Director of the Redevelopment Agency to negotiate and enter into Satisfaction Agreements with eligible developers that detail the terms of the exemption and timelines for compliance.

OUTCOME

Approval of this recommendation will provide more certainty for developers of multi-phase rental projects in San José's Redevelopment Project Areas, providing them with the incentive to begin construction in the near term, and stimulating the economy by creating construction and construction-related jobs and generating fee and tax revenue for the City and the Redevelopment Agency. Four large housing projects in North San Jose are projected to create an estimated 8,819 jobs and pump \$1.13 billion into the local economy over a five-year period and will result in \$9 million in additional annual tax increment revenue by 2018.

BACKGROUND

As a result of a combination of the economic slowdown and the resulting restrictive lending environment that began in the fall of 2008, residential construction activity in San Jose has been

stagnant. Over the past thirty years, building permits were issued each year for an average of more than 3,000 residential units (both multi-family and single-family). Compare this with building permits pulled in 2009, at 307, and for the first six months of 2010, at 306. The numbers are even more dramatic when you consider that the majority of these units were affordable housing projects financed in part by the City.

Many market-rate residential developers had been working for several years to prepare their projects for development and were ready to pull building permits when the market changed and financing became extremely difficult to obtain. Consequently, those developers put construction on hold to await a better, more stable market.

State law requires that 15% of all residential development in redevelopment project areas adopted after January 1, 1976 must be made available and affordable to low- and moderate-income households. To help satisfy the affordable housing requirement imposed by the State, the City Council and Agency Board jointly adopted an Inclusionary Housing Policy (“Policy”) in the mid-1980s. The current Policy generally requires that 20% of all newly constructed housing units built in Redevelopment Project Areas be made affordable to low- or moderate-income households; several alternative methods of fulfilling the requirement are also included in the Policy. Since its adoption, over 1,030 units of affordable housing have been created in Project Areas as a result of this Policy and without any City or Agency funding.

In July 2009, a California Court of Appeals – in a case known as *Palmer/Sixth Street Properties L.P. v. City of Los Angeles* (“*Palmer*”) – ruled that the requirements for rental housing set forth in the City of Los Angeles Inclusionary Housing Program violated the Costa-Hawkins Act, which was approved by the California Legislature in 1995. The Costa-Hawkins Act provides that landlords otherwise subject to rent control may set rents at market-rate whenever units are leased to a new tenant (known as “vacancy decontrol”). The ruling in *Palmer* called into question the validity of inclusionary housing requirements on rental housing projects.

On June 22, 2010, in response to *Palmer*, the City Council/Redevelopment Agency Board amended the Policy to temporarily suspend the applicability of affordable housing requirements for new rental housing developments until such time as the *Palmer* decision is reversed or modified by another court or by the State Legislature. Note that inclusionary requirements for for-sale housing were not impacted by the *Palmer* ruling, and remain in place.

ANALYSIS

Pending Rental Housing Developments in Project Areas

Several large housing developments proposed in Redevelopment Project Areas have obtained full entitlements and are ready to start construction in the near future if financial feasibility can be assured. These include, but may not be limited to, the following four projects located in North San Jose’s Rincon de los Esteros Project Area:

- Fairfield Residential's Northpointe/Baypointe project, consisting of 704 rental apartments in three phases and 21,000 square feet of retail commercial space.
- Irvine Company's Crescent Park project, consisting of 1,750 rental apartments in five phases and a 5-acre park.
- Essex Property Trust's project at the Cadence site, consisting of 769 rental apartments in three phases and a 2.6-acre park.
- Equity Residential's Vista Montana project, consisting of 998 rental apartments in two phases and a 5-acre park.

Developers of large projects, many of which involve multiple phases, need certainty regarding financial feasibility in order to start the initial phases of development since significant infrastructure costs are usually incurred disproportionately in the initial phases.

A City/Agency team, with members from the Office of Economic Development, the Departments of Planning, Building and Code Enforcement, Transportation, and Housing, and the Redevelopment Agency, as well as the City Attorney and General Counsel, has met with the developers of the four identified projects. These developers have stated that they cannot initiate their projects unless they have certainty related to *Palmer*-related inclusionary housing requirements. This is concerning to them because they do not want to start construction of a project without having an understanding of the full cost of development; the uncertainty of a potential inclusionary requirement for a later phase may render the entire project infeasible. The developers agreed that, if the City provides certainty relative to inclusionary requirements, they would have the confidence to initiate construction now, rather than waiting until the economy is more stable.

Potential Freeze of Certain Impact Fees and Taxes

The developers are proposing to move large housing projects forward based on the certainty that inclusionary housing requirements will not be reinstated if *Palmer* is reversed and the developers comply with the phasing plan agreements with the City. They are similarly requesting certainty be provided with respect to impact fees and taxes. The developers have proposed that they not be subject to large fee or tax increases for the four projects noted above. Staff is currently studying this fee and tax proposal, and at this point is considering that only the storm and sanitary sewer connection fees are likely to be subject to significant increases in the next few years. Staff is already in the process of evaluating the infrastructure needs in light of the North San Jose Plan and the draft Envision 2040 General Plan. However, there may be policy and legal issues relating to whether the City will be able to pay the amount of any new fees that will not be paid by the developers pursuant to their proposal. Staff will continue to discuss this issue with the developers and will return to Council with a recommendation on this fee and tax proposal by December 2010.

Proposed Policy Change

Staff recommends that the City Council and Agency Board approve an amendment to the Policy providing that rental projects meeting certain definitions and requirements will continue to be exempted from inclusionary housing requirements under the Policy even if the *Palmer* decision is reversed.

Staff recommends that projects meeting the following minimum qualifications would be subject to this Amendment:

- Projects must be located in a Redevelopment Project Area subject to the Policy.
- Projects must involve new construction of 200 or more units.
- Developer must have obtained a development permit prior to September 1, 2010.
- Developer must pull building permits and commence construction of the project or its initial phase on or before September 30, 2011. In this context, “commence construction” means actual work on foundations, not demolition or site grading.
- All phases of a multi-phase project will be subject to a Phasing Plan approved by the Director of Housing and Executive Director of the Redevelopment Agency. If the project has two or three phases, it must commence construction of all phases no later than September 30, 2013. If it has four or more phases, it must commence construction of all phases no later than September 30, 2014. Each phase must be completed within 30 months. All Certificates of Occupancy must be received within the time period set forth in the Phasing Plan.
- Developers must execute a recordable Satisfaction Agreement with the City and Agency incorporating the above conditions, with said executed Agreement then being recorded.
- If a developer has previously entered into a recorded affordability agreement for a project or phase but has not yet pulled building permits, the Director of Housing is authorized to rescind that affordability agreement applicable to each phase as each phase commences construction.

Reason for Recommendation

Moving these projects forward now is a benefit to the City, creating construction jobs, indirect jobs in construction-related businesses, induced benefits generated as a result (including spending for materials and spending by construction workers), and increased fees and tax revenues. According to a July 2010 study entitled “The Economic Benefits of Housing in California,” authored by the Center for Strategic Economic Research for the California Homebuilding Foundation, the projected number of units to be built in the four developments cited above could create an estimated 8,819 jobs and pump \$1.13 billion into the local economy over a five-year period.

Staff also estimated potential increases in tax increment that could be generated by these potential units by comparing the County Assessor’s Office baseline assessment values for those subject

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parcels against examples of valuations for new, unrestricted rental and ownership housing. Based on this research, the projected number of units to be built in the four developments cited above could create an estimated \$9 million in additional annual tax increment revenue by 2018. This is particularly important to the Redevelopment Agency, which needs to build its increment base in order to offset recent increment drops.

While these figures are only estimates, there clearly will be a significant economic benefit from having large projects proceed during this real estate downturn.

Lastly, because there has been little development activity in the past two years, once employers begin to hire again, there will be a problem with housing supply and availability. When supply doesn't meet demand, rents increase and housing becomes less affordable. San Jose currently has a rental vacancy rate of approximately 4% (with a 5% vacancy rate considered balanced, where there is an adequate supply to meet demand); in recent days, rents have begun to inch up. By starting construction of these units now, housing supply will increase by several thousand units. It is expected that the first units will be ready for occupancy beginning in 2013 and the final units will be available by 2016. So, although these developments will not contain income restricted units, by virtue of their development they will help moderate rents in the general housing market.

EVALUATION AND FOLLOW-UP

Upon approval of these Policy amendments, the Housing Department will assign a project manager to oversee this program. The Housing Department and Redevelopment Agency will negotiate and execute Satisfaction Agreements with those developers able to comply with the conditions for such an exemption. The Housing Department will track and monitor the permit and construction progress of housing projects, and if requested, the City will record a document to evidence compliance with the Inclusionary Housing Policy if the construction deadlines are met. An Information Memo will be provided to the City Council once the Satisfaction Agreements have been completed to update the Council on the progress made.

POLICY ALTERNATIVES

To arrive at this proposal, staff considered the following options:

Alternative #1: Do not amend the Inclusionary Housing Policy as proposed.

Pros: Should the *Palmer* decision be reversed before all phases of currently approved rental housing developments start construction, the latter phases of those projects would be subject to an Inclusionary Housing requirement and the City would gain additional affordable housing units.

Cons: Developers of approved multi-phase rental housing projects have indicated that they will not proceed with construction in the near term because of the uncertainty of whether the *Palmer* decision may be reversed, thereby precluding the economic benefits to the community and increased tax-

increment revenue to the Agency and City that they would otherwise provide.

Reason for not recommending: While the integration of affordable housing units into new projects and developing neighborhoods remains a goal of the City and Agency, the current *Palmer* decision makes it unlikely that inclusionary rental units would be integrated into market-rate rental projects in the near term. The economic development and increased tax-increment benefits of getting approved rental housing projects underway sooner rather than later outweigh the possibility of adding units to the City's affordable housing stock. In addition, increased tax increment generates revenue for affordable housing because 20% of the increment can be used only for low- and moderate-income housing purposes.

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)**

This project meets Criterion 2 above. Accordingly, this Memorandum will be posted on the City's website for the November 2, 2010 City Council meeting. The Policy change is agendaized for discussion at the October 14, 2010 meeting of the Housing and Community Development Commission.

COORDINATION

Preparation of this report has been coordinated with the Office of the City Attorney and the Agency's General Counsel.

COST SUMMARY/IMPLICATIONS

None.

BUDGET REFERENCE

Not applicable.

MAYOR, CITY COUNCIL, AND REDEVELOPMENT AGENCY BOARD
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CEQA

CEQA: Resolution No. 65459 and Addendum thereto, PP08-258



DEBRA FIGONE
City Manager



HARRY S. MAVROGENES
Executive Director

For questions, please contact LESLYE KRUTKO, DIRECTOR OF HOUSING
at 408-535-3851.

