CED Committee: May 24, 2007
Item: h

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

FROM: Leslye Krutko
John Weis

SUBJECT: **CHANGES TO THE INCLUSIONARY HOUSING POLICY IN REDEVELOPMENT AREAS**

DATE: May 23, 2007

Approved Date

SUPPLEMENTAL REPORT

BACKGROUND

Subsequent to the preparation of the May 11, 2007 memorandum to the Committee that outlined a series of fundamental changes to the Inclusionary Housing Policy in redevelopment project areas, staff from the Housing Department and Redevelopment Agency have reached agreement on a series of details on how the proposed changes should be implemented. Additionally, on May 22, 2007, the Department and the Agency hosted a stakeholders meeting of market-rate and affordable housing developers active in or interested in development in project areas.

The purpose of this memorandum is to inform the Committee of the implementation details that will be proposed to the City Council and to respond to a series of suggestions made by the developers. Additionally, we have attached to this Supplemental Report a comparison of restricted rents and market-rate rents that formed the basis for the recommendation for lower income levels in rental projects.

ANALYSIS

1. Developer's Decision Deadline. Staff is recommending that developers have until the issuance of Building Permits to determine which of the four alternatives they want to use to meet their inclusionary obligations. That means that projects currently under construction will not be able to use the new options except when the early phases of a project have pulled Permits. The new options would be available for later phases of the project if Building Permits have yet to be issued.

2. Timing Coordination Between Market-Rate Project and Associated Stand-Alone Project. Staff is recommending that the 100% affordable housing project that is meeting an inclusionary obligation be under construction prior to the issuance of the Certificate of

Occupancy for the market-rate project. In the event that the affordable project has not started construction by the time the market-rate project (or the first phases thereof) is completed, the developer would have the option to pay the in-lieu fees for those market-rate units otherwise ready for occupancy.

3. When In-Lieu Fee Payments Are Due. Staff is recommending that developers be able to pay in-lieu fees at any time between the approval of the last discretionary permit (i.e., Site Development or PD Permit) and completion of the market-rate project. The amount of the fees due are to be based on the fee schedule in effect at the time that the payment is made, however, so developers may wish to pay sooner rather than later in order to avoid paying a possibly higher amount at project completion should the fees be increased in the meantime.

4. Affordability Mix in a Stand-Alone Project. The affordability mix in a 100% affordable housing project – which may be a rental project satisfying a market-rate, for-sale project's obligation – needs to match the corresponding affordability mix that would otherwise have been required in that type of project. Thus, if the stand-alone project is an ownership project, 100% of the units must be affordable to moderate-income (or lower income) buyers. If the stand-alone project is rental, 40% of the units must be affordable to very low-income (or lower) households and 60% must be affordable to low-income at 60% of Area Median Income (AMI) (or lower) households (i.e., the same proportion as the 8% very low-income and 12% low-income required within an otherwise market-rate project).

5. City Subsidies Allowed for Deeper Affordability. Should any developer want to make units more affordable than is required under the policy (i.e., deepen the affordability of rental units to make them affordable to extremely low-income (ELI) households), the Housing Department would be able to provide the additional subsidy necessary to achieve that deeper level of affordability.

6. Pooling Credits for Other Projects. Under this scenario, one stand-alone 100% affordable housing project could satisfy the inclusionary housing obligation of more than one market-rate project. This could be accomplished by: (a) an up-front agreement between two or more market-rate developers; or (b) the affordable housing developer who can build more units than Developer A needs can offer to "sell" the extra affordable units for subsidy by Developer B, C or D.

7. Occupancy of Units with Rents Set at 60% of AMI. "Low-income" is generally described as households earning 51-80% of Median Income. Although the low-income units required under the Policy have to set rent levels at 60% of AMI, eligible tenants would include households up to 80% of AMI. This will give developers a larger pool of prospective tenants to draw upon to get these units occupied.

8. Units That Are Already Affordable. It is possible that the developers of unrestricted for-sale projects will be pricing their units at levels that are affordable to moderate-income buyers. In that event, the developer will need to ensure that at 20% of the buyers are income qualified, but does not need to discount the price of those units.

Issues Raised by Housing Developers That Staff Will Monitor

1. Will the Proposed In-Lieu Fees Promote More-Expensive Market-Rate Housing? The new in-lieu fee structure is a "flat fee" by unit type rather than a variable fee based on the square footage or prices of the market-rate units being built. All other factors being equal, this might encourage developers to build larger, more expensive units in order to minimize the impact of the fees on their profit margins, thereby inflating the general cost of housing in the community. In response, staff would note that the analysis that led to the fees was based on unit size, sales prices, and affordability gaps in the most recent nine projects to be built in redevelopment areas which we believe is indicative of the types of housing that developers believe are appropriate for the housing market in each particular area. Staff will, however, monitor this issue over the next year or two, and will make recommended changes to in-lieu fee structure should a trend toward more expensive housing types emerge. Additionally, we will be monitoring whether the in-lieu fees are set at appropriate levels.

2. Will The New Lower Income Levels Required in Rental Housing Projects Provide a Disincentive for Rental Housing Development? Staff believes that market-rate rental housing production is currently in a slump Citywide (and region-wide) because rents levels have not recovered the declines experienced in the aftermath of the "Dot-Com Bust." Rents have been increasing over the past year, and recent low-vacancy statistics suggest that they will continue to rise. When rents have risen to the level that satisfy developers and lenders, it is our opinion that development of rental housing will rebound.

PUBLIC OUTREACH

The revisions to the inclusionary housing policy have been discussed with the working group advising the Director of Housing on drafting a Five-Year Affordable Housing Plan, the Housing and Community Development Advisory Commission, and a group of market-rate and affordable housing developers at the May 22nd stakeholders meeting. Additionally, Redevelopment Staff has met individually with several of the Downtown high-rise developers to discuss the proposed incentive level of in-lieu fees for their projects.

JOHN WEIS
Deputy Executive Director
Redevelopment Agency

LESLYE KRUTKO
Director of Housing

ATTACHMENT

Restricted vs. Market-Rate Rents in San Jose
First Quarter 2007

UNIT SIZE	Very Low-Income (50% of AMI)	Low-Income (60% of AMI)	Low-Income (80% of AMI)	Moderate-Income (120% of AMI)	Market-Rate
Efficiency	$884	$1,070	$1,441	$2,184	$1053 - $1,120
One-Bedroom	$955	$1,154	$1,552	$2,348	$1,288
Two-Bedroom	$1,133	$1,372	$1,849	$2,804	$1,332 - $1,634
Three-Bedroom	$1,309	$1,585	$2,136	$3,240	$1,900

NOTES:

1. All restricted rents by percentage of AMI reflect a utility allowance that may vary from project to project.
2. SOURCE for market-rate rents: Real/Facts
3. Range in market-rate rents for Efficiency Units is between “studio” and “junior one-bedroom” units.
4. Range in market-rate rents for Two-Bedroom Units is between “one-bath” and “two-bath” units.

CED Committee: May 24, 2007
Item: 4h

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

FROM: Leslye Krutko
John Weis

SUBJECT: **CHANGES TO THE INCLUSIONARY HOUSING POLICY IN REDEVELOPMENT AREAS**

DATE: May 11, 2007

Approved Date

RECOMMENDATION

It is recommended that the Community and Economic Development Committee:

1. Accept this report on proposed amendments to the Inclusionary Housing Policy for redevelopment project areas, including:
    a. Revising the affordability requirements for inclusionary rental units to be 12% low-income and 8% very low-income.
    b. Provide developers with more options to meet their inclusionary housing obligations, including dedication of land for 100% affordable projects and paying in-lieu fees.
    c. Revising the in-lieu fee structure to be closer to the cost to the market-rate developer if the inclusionary units were included within the development, except for providing a discounted, incentive-level fee to the developers of high-rise residential development in the Downtown Core Area.

2. Provide feedback to the City Administration and Redevelopment Agency staffs on crafting recommended Policy amendments to the full City Council and Redevelopment Agency Board.

BACKGROUND

State law requires that at least 15% of the housing developed in redevelopment project areas established since 1976 be affordable, with 6% affordable to very low-income households and 9% affordable to low- or moderate-income households. Three downtown redevelopment project areas were established prior to 1976 and are therefore exempt from this requirement: San Antonio Plaza, Park Center Plaza, and Pueblo Uno.

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 33413(b)(2)" in the 1980s. The Policy was most recently amended on June 21, 2005.

In general, the Policy requires that the 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, as follows:

- In rental housing developments, 20% of the units must be affordable, with at least 8% of the units restricted to very low-income households.
- In for-sale developments, the requirement is either 20% 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.

The implementation of the Policy requires that the affordable units be spread throughout the housing development and have the same sizes, finishes and amenities that the developer is providing in the market-rate units. Projects of 10 or fewer units are exempt from the Policy, and developers of projects of 11 to 20 units may, at their option, pay an in-lieu fee to the Housing Department to help finance the City's affordable housing programs. The current in-lieu fees, established in the annual Fee Resolution adopted in conjunction with the annual City Budget, are $65,000 for ownership units and $71,400 for rental units.

ANALYSIS

The Policy has been revised a number of times since its original adoption to meet special conditions that various developers have encountered, and in the face of major changes in the nature of the redevelopment project areas, most notably the inclusion of the Strong Neighborhoods into the Merged Project Area in 2002.

Based on concerns raised by housing developers about the rigidity of the current Policy and in working with various developers on certain specific inclusionary issues, the Redevelopment Agency and Housing Department staffs have concluded that a fresh look at the Policy in its entirety is warranted.

The amendments that staff is proposing can be grouped under three major topic headings.

Revised Affordability Requirements for Rental Housing

In the planning efforts leading up to the inclusion of the Strong Neighborhoods into the Merged Project Area, it became clear that compliance with the Policy then in force on affordability levels (6% very low-income and 9% low- or moderate-income, in strict conformance to State law) was not feasible for ownership housing developers. It was this segment of the housing-development industry that was expected to play the biggest role in the Strong Neighborhoods.

Instead of applying the same 6%/9% formula across the board, it was determined that different affordability standards should apply to rental vs. ownership housing development. This conclusion formed the basis for the current affordability requirements:

- For rental housing developments, 20% of the units must be affordable, with at least 8% of the units restricted to very low-income households and 12% low- or moderate income.
- In for-sale developments, the requirement is either 20% 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.

Unfortunately, the requirement that 12% of units in rental housing projects be either low- or moderate-income results in units that are priced at about market-rate in the case of low-income and, theoretically, above market-rate in the case of moderate-income. In other words, the current standard is not providing affordable housing as intended or desired.

To remedy this situation, it is recommended that the requirements for rental income be revised to 8% very low-income and 12% low-income, with the latter being pegged at 60% of Area Median Income (AMI), which is the income level required for low-income units under the Low-Income Housing Tax Credit Program administered by the State.

Staff also recommends dropping the alternative for ownership projects (the carry-over of the original 6%/9% formula) since, as a practical matter, making for-sale affordable to very low-income households is something only niche developers like Habitat for Humanity can achieve, and then only with very large subsidies.

Greater Flexibility for Developers

Most developers of housing in redevelopment project areas are required to integrate the inclusionary units into their projects. This has been based on the policy objective of achieving socio-economic integration in the community at the smallest possible scale (i.e., project-by-project).

While staff wants to retain unit-by-unit integration as the preferred approach for developers, we are offering three other methods for developers of projects exceeding ten (10) units to meet their inclusionary housing obligation that they could choose at their sole option. These alternatives recognize that many market-rate developers are ill-equipped to deal with units subject to affordability restrictions (e.g., marketing to moderate-income buyers or low-/very low-income renters, and having to comply with annual reporting requirements for rental projects).

a. Provide a stand-alone affordable project within the same redevelopment project area. This approach has been promoted by several developers. While normally expressed as the "dedicate-land-to-a-nonprofit-developer" option, the subsidy that the market-rate developer would need to provide could well end up exceeding just the value of dedicated

land (as, when the City provides gap financing to affordable housing developers, the City subsidy amount exceeds the price of raw land). For purposes of this option, the stand-alone affordable project would not need to be the same type (e.g., the market-rate for-sale project could be paired with an affordable rental project). Although this alternative would not achieve socio-economic integration on a project-by-project basis, it would achieve that objective on a project area basis.

b. Pay fees in lieu of providing inclusionary units on-site or next door. Coupled with a revision to the way inclusionary in-lieu fees are structured (see below), this option would allow developers to place the responsibility for meeting the inclusionary requirement on the City and the affordable housing developers . Though this option will not promote socio-economic integration in developing neighborhoods in redevelopment project areas, it does have the distinct advantage of providing the City with an additional income stream to finance units affordable to extremely low-income (ELI) households, an income level not addressed in the inclusionary housing program but which is necessary to respond to the need for housing for extremely low-income households.

c. Combine a stand-alone project with paying in-lieu fees. Under this alternative, part of the inclusionary obligation would be met by a stand-alone project and the other part by paying in-lieu fees. This is essentially the alternative way for a developer to fulfill the inclusionary housing obligation that is agendized for City Council/Redevelopment Agency Board consideration on May 15, 2007 in connection with a housing development proposed in the Burbank/Del Monte area by the Sobrato Group.

In 2005, the Nonprofit Housing Association of Northern California (NPH) and the California Home Builders Association (HBA) jointly published "On Common Ground." This report concluded that localities' inclusionary housing requirements should be as flexible as possible. This objective would be achieved by the proposals to offer developers the alternatives of a stand-alone affordable housing project, paying in-lieu fees, or a combination thereof.

New Inclusionary In-Lieu Fees and Fee Structure

The current inclusionary in-lieu fees are $65,000 for each for-sale unit and $71,400 for each rental unit not otherwise provided by the developer. Both were based on the cost to the City to subsidize for-sale and rental units, respectively, in the Spring of 2006 when the fees were last updated. Since that time, construction costs alone have increased more than 20%.

We are proposing a new approach to determining the level of fees to be imposed, that of pegging the fee at a level equal to or slightly below what, on average, what it would cost the developer to provide the affordable unit within the otherwise market-rate project. Using that approach, the proposed new fee schedule for each unit not otherwise being provided is proposed to be:

Product Type	Per-Unit Fee
Rental Units	$85,500
For-Sale – Low-Rise Condominium/Stacked Flat Units	$90,000
For-Sale – Townhouse/Row-House Units	$120,000
For Sale – Single-Family Detached Units	$200,000
For-Sale – High Rise not in Downtown Core	$200,000

The one product type not included in the above fee schedule is high-rise, ownership housing (defined as at least ten floors of housing) in the Downtown Core Area. This product type is one that the City is actively encouraging and for which the Mayor's Budget Message promoted the development of incentives. If the same "developer's-cost-to-provide-affordable-unit" approach used above was applied to downtown high-rise development, it is estimated that the fee would be $250,000 per unit based on the reservations and asking prices of the two projects currently on the market. To comply with direction to provide incentives for this housing type, therefore, we are proposing a per-unit fee of $65,000 for each affordable unit (at 20% of the total number of units) to be paid by developers of high-rise, ownership housing in the Core Area. This incentive is proposed to expire after building permits for 2,500 downtown high-rise units have been issued, at which time it will be re-evaluated.

PUBLIC OUTREACH

These proposed changes to the Inclusionary Housing Policy were presented to the Five-Year Housing Plan Task Force on May 4, 2007 and to the Housing and Community Development Advisory Commission on May 10, 2007.

A meeting of market-rate and affordable housing developers is scheduled for May 22nd.

CONCLUSION

We look forward to discussing these proposals as well as other ideas about the City's inclusionary housing program at the Committee's May 24, 2007 meeting.

JOHN WEIS
Deputy Executive Director
Redevelopment Agency

LESLYE KRUTKO
Director of Housing