



# Memorandum

**TO:** COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

**FROM:** Leslye Krutko

**SUBJECT:** CITYWIDE INCLUSIONARY HOUSING ORDINANCE

**DATE:** November 14, 2008

Approved

Date 11/14/08

**COUNCIL DISTRICT:** Citywide  
**SNI AREA:** All

## RECOMMENDATION

It is recommended that the Community and Economic Development Committee: (1) review the recommendation contained herein for an inclusionary housing ordinance; (2) review alternatives for an inclusionary housing ordinance (Attachment A) that were considered and are not recommended; and (3) approve staff's recommendation to the City Council for the adoption of an ordinance for an inclusionary housing requirement on residential development Citywide.

## OUTCOME

Proceeding with the development of a Citywide inclusionary housing ordinance, as recommended, will increase the production of affordable housing in San Jose by an estimated 450 units annually for the foreseeable future.

## EXECUTIVE SUMMARY

In June, the City Council directed the Administration to return to the City Council in the fall with an inclusionary housing proposal for Council consideration. The Housing Department, in collaboration with the Redevelopment Agency (RdA), the Planning, Building and Code Enforcement Department, and the City Attorney's Office, has worked since that time to respond to this direction. More than 30 one-on-one meetings and more than two dozen stakeholder and public meetings have been held to gather input to frame the recommendations. To get to this point, the Department has also completed significant research and study of existing inclusionary ordinances, and met with cities that have experience with implementing Citywide programs to gather best practices.

Included in this memorandum is a recommendation for the framework of a Citywide inclusionary housing ordinance. The Department's recommendations are listed, along with a

rationale for selection. Attached is a detailed discussion of all the alternatives and the related advantages and disadvantages (Attachment A).

## **BACKGROUND**

The subject of inclusionary zoning has been a discussion point in San Jose for the past 20 years. When the City Council created the Housing Department in 1988, it approved a Mayor's Housing Task Force Report that included a recommendation to explore ways to implement inclusionary zoning. After a task force effort, no consensus was reached on whether to support such a policy, and the City Council was not asked to consider whether inclusionary zoning was desirable.

In 2001, the City Council accepted a report by the Mayor's Housing Production Team which included an action to implement an inclusionary zoning policy for all rental housing in San Jose. This effort, also, did not result in a decision to implement such an action.

In June of 2007, the Mayor and City Council adopted the Five Year Housing Investment Plan, which lays out a series of recommendations and alternatives for addressing the City's affordable housing need. One of the alternatives included in the report was to review the potential to geographically expand the current inclusionary housing program beyond the redevelopment project areas boundaries. Currently, about one-fifth of the City's land area is covered by the redevelopment-area inclusionary policy, including all of the City's 19 Strong Neighborhood Initiative areas.

At a study session on December 11, 2007, the City Council directed staff to proceed with a study of a Citywide inclusionary housing program, including a series of three public meetings with a consultant who was charged with completing an economic feasibility analysis of inclusionary housing in San Jose.

On June 17, 2008, the Mayor and City Council directed the Administration to conduct outreach and return in the Fall of 2008 with an Inclusionary Housing proposal for Council approval that includes a range of alternative elements, as specified. Additionally, the Administration was directed to provide a status report that detailed how the City's affordable housing goals and affordable housing programs had performed over the past two decades and a report that details opportunities and alternatives to increase the supply of affordable housing as identified by the development community.

On November 10, 2008, the City Council met in a Special Session to discuss the process for reviewing this Inclusionary Housing Proposal and whether additional information was needed for the Council to make an informed decision. The Council directed the Administration to proceed with bringing forward a proposal for a Council decision on December 9, 2008. The Council directed the staff to incorporate the recommendations included in Vice Mayor Cortese's November 10, 2008 memo in the alternatives presented. Additionally, the Council requested that the staff bring back additional information that will inform the City Council, including

comments received during the outreach process, alternatives to inclusionary programs, and housing production data. Included in this memorandum are those alternatives and the Department's recommendations. Information on the additional information requested – including positive and negative comments received during the outreach process – is forthcoming.

Recommendations in this memorandum accept a number of the recommendations included in Councilmember Cortese's memo, but not all. Please note that the recommendation to take a number of steps related to the Redevelopment Agency will be addressed at a later date.

## **ANALYSIS**

### **Why Should an Expanded Inclusionary Housing Program Be Considered?**

There are several important reasons why the City should consider adopting an inclusionary housing proposal. First, although the City has facilitated the production of substantial numbers of affordable housing units through its financing programs, and arguably has exhibited leadership in providing affordable housing opportunities for its citizens that other cities cannot claim, there is still a significant unmet need for affordable housing in San Jose. A report released in 2007 – prepared by San Jose State University and the Local Initiative Support Corporation, entitled "*Housing Silicon Valley: A 20-Year Plan to End the Affordable Housing Crisis*" – found that the County of Santa Clara has a significant current and future need for affordable housing and that insufficient local funding is available to meet this need. The City is currently preparing its Housing Element, as dictated by California State law, which requires that the City plan for the development of 19,000 affordable units between the years 2007-2014.

The City's financing programs have created more than 17,000 units since the creation of the Housing Department 20 years ago. This has been possible largely due to the City's successful Redevelopment Agency, which has allocated a portion of its 80% funding for affordable housing in addition to the required 20% of tax increment that is transferred to the City's Housing Department. However, because this source of funding -- 20% Low and Moderate Income Housing Funds (20% Setaside) -- is limited, the City will need to add to its tool box to ensure that it has the resources available to continue to meet the need for affordable housing in the future.

Given current demand for funding, it is projected that the 20% Set-Aside will be exhausted in the next three to five years. Should the Redevelopment Agency be successful in its efforts to increase its expenditure cap, an effort that is currently underway, the Housing Department would have additional ability to borrow. However, this will be limited by the incremental increase in tax increment each year, which will restrict the amount of money available for new projects each year.

The City strives to be a place where people can both live and work. This is not only key to a healthy economy, but is crucial as we plan to create a sustainable community and the City's ability to meet greenhouse gas emission goals and other environmental priorities. Ensuring that

there are affordable choices for the area's low- and middle-wage earners is important to the future success of the City.

Additionally, the City has had a long-standing policy objective of dispersion of affordable housing and socio-economic integration. To the extent that developers incorporate affordable units into their developments, such integration can be achieved.

### **Guiding Principles**

Feedback from outreach efforts since June 17<sup>th</sup> led the Housing Department to use the following Guiding Principles in developing a recommendation for a Citywide inclusionary housing policy:

- **Simplicity** – An inclusionary housing policy should be easy for the developers to understand and for the City to administer.
- **Flexibility** – An inclusionary housing policy should give developers as many alternatives as possible for compliance.
- **Consistency and Fairness** – All developers should be treated equally, particularly with respect to projects in the pipeline.
- **Certainty** – Developers, affordable housing advocates and the City should have advanced knowledge of what the impacts and outcomes will be with an inclusionary housing policy. The rules and process of the inclusionary housing policy should be clearly defined.

### **Recommended Policy Provisions**

The Housing Department, in conjunction with the Redevelopment Agency, has worked diligently over the past several months to meet with stakeholders and the public to gather input as directed by the City Council. In addition to one-on-one meetings and meetings with stakeholders, the public, and Council Commissions and Committees, the Department has completed substantial research to ensure that the proposal it brings forward is comprehensive and meets the Guiding Principles listed above.

In this outreach process, a wide variety of alternatives were suggested on how to craft an inclusionary housing ordinance. Those alternatives, together with advantages and disadvantages of each, are included in Attachment A. After considering all of these suggestions, the Housing Department is recommending the following policies to serve as the basis for a Citywide Inclusionary Housing Ordinance:

COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

November 14, 2008

Subject: Citywide Inclusionary Housing Ordinance

Page 5

<b>Inclusionary Requirements</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
Geographic Applicability	Ordinance requirements will apply to all residential development citywide, including redevelopment areas.	Meets the guiding principles of fairness and consistency, and certainty. A developer working outside of a redevelopment project area will have the same requirements as a developer working in an RdA project area.
Percent Set Aside and Income Targeting Requirement	Rental—Developer chooses one of two options: 20% or 15% depending on depth of affordability. For-Sale—Developer chooses one of two options: 20% or 15% depending on depth of affordability.	Meets goal of flexibility, and provides options for increased affordability.  Meets goal of flexibility, and provides options for increased affordability.
Partial Units	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.	Allowing developers to address inclusionary obligations of fractional units by paying a pro rata in lieu fee or providing a full unit if the fraction is 0.5 or above provides more flexibility for developers while ensuring that the Ordinance's affordable housing goals are met.
Threshold	Ordinance requirements will apply to developments with 11 or more units.	Applying the inclusionary requirements only to developments of 11 or more units is consistent with current RdA policy. It exempts smaller developments, for which complying with inclusionary obligations may not be economically feasible.
Term of Affordability	Rental: Inclusionary units must remain affordable for 55 years. Owner: Inclusionary units must remain affordable for 45 years.	Requiring a 45 year affordability term for ownership units and a 55 year term for rental units is consistent with minimum Redevelopment Law requirements. The units will therefore be counted towards the City's affordable housing production requirements.
Type of Resale Restriction for Ownership Units	Inclusionary ownership units must contain a shared-equity provision.	A shared equity provision allows the original buyer of an affordable unit to sell the unit at the market price and earn a portion of the appreciation of the home. Upon resale, the City recaptures the difference between the market price and the affordable price of the unit plus a portion of the appreciation. The City then uses these funds to assist another buyer to purchase a home anywhere in the City. This provision is consistent with current RdA policy and provides for more choice and flexibility for homebuyers. It also may make it easier to find willing buyers of affordable units, as they have the

COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

November 14, 2008

Subject: Citywide Inclusionary Housing Ordinance

Page 6

<b>Inclusionary Requirements</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
		opportunity to earn equity upon resale of the unit.
Operative Date of Ordinance	Ordinance takes effect after the customary time of 30 days after final adoption, but does not become operative until the later of: (1) January 1, 2010, or (2) the first day of the month following the first 12-month consecutive period in which building permits for 2,000 units have been issued, as certified by the Housing Department Director or his/her designee.	By tying the Ordinance's operative date to building permit activity, this provision allows the market to recover to a certain level before the inclusionary requirement is imposed. Over the last 20 years, the number of building permits has fallen under 2,000 three times and this correlates with down economic periods in the City. This delayed operative date will provide sufficient time for developers to adjust their financial and development assumptions to accommodate the Ordinance's requirements.
Grandfathering/Pipeline	<p>Developers meeting the following requirements will be exempt from the requirements of the Ordinance:</p> <ul style="list-style-type: none"> <li>a) Within three months of the effective date of the ordinance, the developer submits an applications for a planning permit (CUP, site development, or PD permit) and environmental clearance that are deemed substantially complete by the City pursuant to the provisions of the Zoning Ordinance and the Environmental Clearance Ordinance, and</li> <li>b) Within twenty-one months after the effective date of the ordinance, the developer receives an approved planning permit; and</li> <li>c) Within twenty-seven months after the effective date of the ordinance, the developer receives an approved building permit.</li> </ul> <p>For phased developments, the above timelines apply to the first phase; each subsequent phase must obtain building permits within two years after the issuance of permits for the prior phase.</p> <p>These times will be extended by the amount of time necessary to resolve delays imposed by non-City environmental or other regulatory agencies.</p>	<p>By exempting from inclusionary requirements those developments that have already invested time and resources into planning and predevelopment and that demonstrate continuous progress toward entitlement and permitting, the Ordinance promotes fairness for those developments currently in the pipeline. It also ensures that those exempt developments are verifiably in the development process.</p> <p>Developers of large, phased projects have invested funds in planning, and they should be able to lock in development costs and pricing for all phases to be exempt from the inclusionary ordinance if the phases continue to be built on a reasonable schedule.</p> <p>This exception would provide relief in cases where delays are outside the control of either the developer or the City.</p>

<b>Inclusionary Requirements</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	Upon passage of the ordinance, developments under the current RdA inclusionary policy may opt to participate with requirement consistent with the Citywide ordinance as long as Building Permits have not been issued.	This will provide additional flexibility to pipeline projects located in redevelopment project areas.
Pressure Relief Valve	When the gap between the market price and the affordable price for homeownership units targeting the lowest area median income (AMI) is \$10,000 or less, the following requirements will apply: <ol style="list-style-type: none"> <li>1. No equity share provision will be required.</li> <li>2. The home must be sold to the first buyer at the restricted price.</li> <li>3. No income verification of the buyer will be required.</li> <li>4. The unit must be owner-occupied.</li> <li>5. Developer must certify that the relief is needed every six months.</li> </ol>	This provision allows the Ordinance to adjust to periods of demonstrated economic distress in the development community, promoting fairness for developers.

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
The following alternatives to providing the affordable units on-site will be available. Specific criteria will be developed that define the parameters under which these options may be exercised.		<p>The Ordinance provides developers with alternative compliance options for meeting their inclusionary obligation in ways other than providing affordable units on-site. Offering alternative compliance options may offer the City opportunities for more affordable housing development outside of the market rate developments.</p> <p>The Ordinance provides for cost-saving offsets for developers that meet their inclusionary requirement by providing affordable units on-site. These offsets will decrease costs for developers and provide an incentive for on-site development of the affordable units, thus increasing the economic integration of developments and neighborhoods.</p>

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
Off-Site Construction	A developer may build affordable inclusionary units off-site, with limitations placed on the off-site location options. Approval will be granted if the off-site location is demonstrated to be consistent with City policies or if the developer partners with an experienced affordable housing provider.	Off-site construction may be a good option, and can often result in more deeply affordable units. Additionally, a separate and distinct project can apply for affordable housing subsidies that can make a project more economically feasible.
Credit Trading or Credit Transfer -- General	Developers may transfer and/or trade inclusionary unit credits to pool together and build larger affordable projects off-site.	Some developers have only a small requirement and would benefit by "buying" credits from another developer. Other developers may have the ability to build additional units and would benefit by "selling" units to a developer who needs to meet an inclusionary requirement.
Credits for Housing Preservation	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.	This will incentivize owners of HUD-subsidized units to keep the units affordable.
In Lieu Fee	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. The City will use the in-lieu fees to provide funding for: <ul style="list-style-type: none"> <li>a) at least 30% of the funds collected will be used to develop housing for households earning at or below 30% of the AMI;</li> <li>b) cover reasonable administrative or related expenses associated with the administration of the ordinance, including funding for streamlined planning review.</li> </ul>	In order to meet legal requirements, an in-lieu fee must have a rational basis. In the past, the RdA program has used a calculation that relates to the cost of subsidizing a like unit. Because it is most likely that the City will use in-lieu fees to subsidize rental unit construction, it follows that the in-lieu fee should be equivalent to the subsidy required by the City to finance an affordable rental unit. A priority for the expenditure of funds received through the payment of in-lieu fees should be to assist ELI units. To facilitate special handling of those developments that choose to integrate the units in their development, the use of a small amount of in-lieu fees would be used to pay for City staff assigned to this function.
Land Dedication	The developer may provide developable land instead of providing units on-site if the site is suitable for residential	In some situations, land dedication can be a favorable alternative and should be an option.

<b>Alternative Compliance Options</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	development and the land value is sufficient to meet the inclusionary requirement without additional City funding.	
Acquisition and Rehabilitation	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 ordinance 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.	While the City needs new construction of affordable housing, it is also important to maintain the existing housing stock. By acquiring and rehabilitating market-rate development and restricting rents, the results include an increase in affordable housing opportunities and neighborhood improvement. However, since these units do not count one-for-one toward the City's housing goals, it is appropriate that a developer be required to acquire and rehab four units for every inclusionary unit required.
Combination	The developer may comply by combining alternative compliance options.	The City and Redevelopment Agency have found, in the implementation of the current RdA policy, that at times a combination of options is desirable. This will also reduce the potential to revise the ordinance each time a new situation presents.

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
The following offsets will be offered to developers who meet their inclusionary obligation by providing affordable units on the same site as the market rate development:		
Density Bonus	The developer that provides the affordable units on-site may receive a density bonus equal to the percentage set aside required by the Ordinance, provided it is consistent with State density bonus law.	Density bonuses are required by State law. While the City is proactive in supporting the highest possible densities, this is an offset that is encouraged to be utilized by developers.
Reduction in Minimum Parking Space Requirements for Affordable Units	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.	Parking reductions are strongly encouraged for developments in proximity to transit and/or in combination with Ecopasses or car-sharing being made available to residents. Reductions in parking can reduce construction costs.
Altered Setback Requirements	With the approval of the Planning Department Director, a development	Setback requirements address neighborhood character and modifications may be

COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

November 14, 2008

Subject: Citywide Inclusionary Housing Ordinance

Page 10

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	that provides the affordable units on-site may be granted altered setback requirements for the affordable units.	appropriate on a case-by-case basis. Reduced setbacks may provide for the construction of additional affordable units.
Alternative Product Type	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.	This option allows the most flexibility for developers, particularly those who are building a high cost, low-density product.
Alternative Interior Design Standards	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.	Different interior design works well for for-sale housing, and less well for rental housing. Nevertheless, as long as the materials used are of good quality, one way of achieving affordability is by reducing high-cost interior finishes.
Expedited Review	A development that provides the affordable units on-site will be offered an expedited review process.	We heard many times that time is money. With this recommendation, developers who choose the on-site option would get expedited review with mutually agreed upon milestones for performance both for the City and the developer.
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.	The City will provide additional technical assistance to any developer choosing to incorporate the units on site. This encourages developers to do so, furthering the City's goal of economic integration.
Financial Subsidies	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.	Some cities do not allow inclusionary projects to apply for other sources of government money. Based on feedback received, we are recommending that this be allowed, even though the projects would conceivably compete with City-subsidized developments. In an effort to increase ELI construction, the City will provide a partial subsidy to developers who agree to reduce rents to lower than required levels.
Park Fee Exemption	Rental units that are affordable to households earning less than 60 percent of area median income (AMI) are exempt from paying the Park Fee.	This is current City policy and because of the income criteria, it applies only to rental projects. No change is recommended at this time because the policy is under separate review.
Property Tax Exemption	Developers who partner with nonprofit housing developers and provide rental	This is current law, and because of the income criteria, it applies only to rental

<b>Offsets</b>		
<u>Issue</u>	<u>Recommendation</u>	<u>Rationale</u>
	units affordable to households earning less than 80 percent of AMI are exempt from paying property taxes, provided the nonprofit meets the standards set forth in the California Revenue and Taxation Code Section 214 and has "material participation" and "substantial management duties" in the project, as defined in the California Board of Equalization Rule 140.1.	projects. This property tax exemption is not available for ownership housing.
Construction Tax Exemption	Rental units that are affordable to households earning at or below 50 percent of AMI are exempt from paying the Building and Structure Construction Tax, the Construction portion of the Construction and Conveyance Tax, the Commercial-Residential Mobilehome Park Building Tax, and the Residential Construction Tax.	This is current City policy. Because of the income criteria, it applies only to rental projects. No change is recommended at this time.

**POLICY ALTERNATIVES**

In reaching the recommendations spelled out above, the following alternatives were also considered:

**Alternative #1:** *Do not expand inclusionary housing requirements beyond redevelopment project areas.*

**Pros:** The City's current efforts, including its financial assistance programs and the RdA inclusionary requirement, are producing a significant number of affordable units. Expanding the program would require additional administrative efforts. This is the wrong time to implement such an effort because the economy is at its lowest point in decades.

**Cons:** Despite the City's efforts, a large number of San Jose residents do not have adequate or affordable housing. Additionally, the City's 20% funds are limited, and will not allow the level of past production or meet the future production needed. The recommendation recognizes the current market conditions, and waits until the market has stabilized before developers are required to comply. An estimated 450 units will not be produced each year if a Citywide inclusionary program is not adopted.

**Reason for not recommending:** The City Council has directed the Housing Department to return with a proposal that expands inclusionary housing requirements beyond redevelopment areas based on the City's need to have all the tools in the toolbox to address the

affordable housing crisis. Inclusionary housing programs are used by the majority of cities in Santa Clara County and by neighboring cities and counties in Santa Cruz, San Mateo, and Alameda Counties.

**Alternative #2:** *Adopt a Citywide inclusionary housing program with different detailed requirements than those recommended by staff.*

**Pros:** The City Council may prefer certain options over others for a variety of reasons. While there are dozens of inclusionary programs in the Bay Area, they are all different, so there is no right or wrong programmatic design.

**Cons:** City and Redevelopment Agency staff have spent a great deal of time researching effective inclusionary programs and meeting with developer and advocate stakeholders. The recommendations included in this memo take into account what we heard during those one-on-one and public meetings.

**Reason for not recommending:** The recommendations represent a thoughtful effort to respond to concerns raised by stakeholders and to implement the four Guiding Principles.

**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)*

The recommended action meets the Criteria #2 above. E-mail notification of the Committee's meeting and subsequent consideration of the issue by the full City Council will be sent to the Department's list serve of over 700 names and this report will be posted to the Committee's agenda posted on the City's website.

Other public outreach efforts have included the following:

January – March 2008	Three developer stakeholder meetings with the consultant preparing the economic feasibility analysis of inclusionary housing.
May – June 2008	Four open public forums throughout the City to share the results of the economic feasibility analysis.

COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE

November 14, 2008

Subject: Citywide Inclusionary Housing Ordinance

Page 13

August – October 2008	35 one-on-one meetings with developers, other business interests and affordable housing advocates.
September 2008	One stakeholder meeting of affordable housing advocates.
September – October 2008	Two stakeholder meetings of developers and related business interests.
October – December 2008	Eight open public forums throughout the City to discuss potential parameters of a Citywide inclusionary housing policy.
June-November 2008	Twelve City Council Commission and Committee meetings where inclusionary housing was discussed.

**COORDINATION**

Preparation of this memorandum was coordinated with the Department of Planning, Building and Code Enforcement, the Redevelopment Agency, and the Office of the City Attorney.

**CEQA**

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

  
**LESLYE KRUTKO**  
Director of Housing

ATTACHMENT A—Analysis of Alternatives Considered

The following attachments will be delivered with a Supplemental Memorandum:

- ATTACHMENT B—Comments Received During the Outreach Process (July to Date)
- ATTACHMENT C—Alternative Policies and Funding Sources for Affordable Housing
- ATTACHMENTS D1 – A&B — Survey of Inclusionary Housing in Santa Clara County
- ATTACHMENTS D2 – A&B – Survey of Other Cities with Inclusionary Housing
- ATTACHMENT E—Map of Inclusionary Housing
- ATTACHMENT F—Analysis of Past and Future Housing Production and Inclusionary Requirements
- ATTACHMENT G—Literature Review of Inclusionary Housing Programs

For questions, please contact Leslye Krutko, Director of Housing, at 535-3851.



## ATTACHMENT A

### Analysis Of Alternatives Considered

The following discussion provides an analysis of the Inclusionary Housing Ordinance policy alternatives that were considered in determining the proposed recommendations. Each issue is presented below, with a discussion of the possible policy alternatives for addressing each issue, and the advantages and disadvantages of each alternative.

#### Part A: Inclusionary Housing Requirements

##### A-1. Geographic Applicability

This issue refers to the scope of the proposed Ordinance. The alternatives are as follows.

- a) Applies only to areas outside of Redevelopment project areas, with the Redevelopment Agency (RDA) policy continuing to apply to the project areas.

*Disadvantages:* May be unfair to have different inclusionary housing obligations apply to different areas of the City. This may cause confusion for developers in determining which inclusionary requirements apply to their projects, unless the same standards as the RDA policy are adopted citywide.

- b) Applies citywide, including RDA project areas. In this alternative, the City's Ordinance supersedes the RDA inclusionary requirements within RDA project areas.

*Advantages:* While it depends on the specifics of the Ordinance adopted, an Ordinance that applies to the entire City may provide more certainty, consistency and fairness to developers.

*Disadvantages:* If the Ordinance is implemented citywide and the set-aside percentage required is lower than Redevelopment Law requirements, production may fall below the amount required by State law and the RDA may not be able to meet its State affordable housing production requirement.

- c) The Ordinance applies citywide but excludes low-income neighborhoods.

*Advantages:* This will ensure that affordable housing is dispersed outside of low-income neighborhoods and ensures the equitable distribution of low income housing citywide.

*Disadvantages:* First, it is important to note that inclusionary housing programs, by their nature, integrate affordable units in market-rate projects. A mixed-income development should be a positive in lower-income neighborhoods. Several lower-income areas, like the Mayfair SNI neighborhood, have embraced the development of affordable housing and even requested deeper affordability than developers originally planned. In addition, the

development of affordable housing can assist in the revitalization of lower-income neighborhoods.

## **A-2. Set Aside and Income Targeting Requirements**

This issue refers to the percent and level of affordability of a development's inclusionary obligation under the Ordinance. The inclusionary obligation is determined as a specified percentage of the development's total units. For example, the Ordinance may require a higher percentage of units that are affordable to moderate-income households and/or a lower percentage of units that are affordable to lower-income households. By combining a higher percentage of required units with moderate affordability levels and a lower percentage of required units with deeper affordability, the economic impact on the developer may be equalized.

Staff presented the options below to the public and stakeholder meetings and solicited comments and feedback on the correct combination of the percentage of units and income targeting requirements. The combinations may differ for homeownership and rental developments.

Staff has analyzed options for implementing these alternatives. Under California law, moderate-income households are those earning over 80 percent and up to 120 percent of area median income (AMI), adjusted for household size. For homeownership, to ensure that units are affordable to most households within that income range, affordable sales prices are calculated using a household income ranging from 95 percent to 110 percent of AMI. For rental units, income ranges are calculated from 40 percent to 60 percent of the AMI. In order to ensure there are willing renters and buyers for affordable units, the affordable rents and sales prices in this income category must be sufficiently below market rents and sales prices. Staff has therefore analyzed the effects of pricing the rents and sales prices for this income category at 40, 50, 60, 90, 95, 100 and 105 percent of AMI, in addition to 110 percent of AMI.

- a) High percentage, twenty percent (20%) of affordable units required; homeownership units targeted at moderate- income households; rental units targeted at moderate to lower income households.

*Advantages:* Requiring a higher number of affordable units will result in more affordable units being produced through the Ordinance. A higher set aside obligation is moderated by requiring the units to be affordable to moderate- or lower-income households. Targeting homeownership units to moderate-income households is prudent and may avoid the difficulties in meeting mortgage payments that lower-income households may face.

*Disadvantages:* While more overall units are produced under this alternative, no units with deeper affordability will be produced. The City therefore may miss an opportunity to produce extremely-low, very low- and low-income units through the Ordinance. The City's need for units affordable to these income levels is substantial, especially for renter households. Meeting the need for units with deeper affordability would then fall to the City, requiring substantial public subsidy.

- b) Medium percentage, fifteen percent (15%) of units required; homeownership units targeted at moderate to median income households; rental units targeted to lower- to very low-income households.

*Advantages:* Allows for additional affordability without imposing an unreasonable burden on the developer. For homeownership units, can make the units easier to market by enabling a larger group of households to qualify to purchase. Fifteen percent is the minimum percentage required by state Redevelopment Law.

*Disadvantages:* The financial effect of requiring deeper affordability is tempered by requiring fewer overall affordable units.

- c) Low percentage, ten (10%) of units required; homeownership units targeted at median to low-income households; rental units targeted to very low- to extremely low-income households.

*Advantages:* The financial effect of requiring deeper affordability is tempered by requiring fewer overall affordable units. Requiring rental units affordable to extremely low- and very low-income households will assist the City in meeting a priority affordable housing need.

*Disadvantages:* Fewer overall units will be produced under this alternative. Targeting homeownership units to median and low-income households may be risky, as these households are often less financially stable and may have a higher risk of foreclosure. Prudent underwriting standards are important.

### **A-3. Partial Units**

This issue addresses the cases when a development's inclusionary percentage requirement results in a partial unit obligation. The alternatives for addressing this issue are:

- a) The inclusionary obligation is rounded up for any fraction of a unit. If an in-lieu fee payment is allowed under the Ordinance, the developer can choose to provide the full unit or to pay a pro rata in-lieu fee equal to the fraction of the unit that is required.

*Advantages:* By rounding up for any fraction of a unit, more affordable units will be produced under the Ordinance. Provides flexibility by allowing developers to produce the unit or pay the in-lieu fee.

*Disadvantages:* The economic effect of the inclusionary obligation on developers whose obligation results in a partial unit will be increased.

- b) The inclusionary obligation is rounded up only when the requirement results in a fraction of a unit that is 0.5 or higher. In this case, if an in-lieu fee payment is allowed under the Ordinance, the developer could chose to provide the full unit or to pay a pro rata in-lieu fee equal to the fraction of the unit that is required.

*Advantages:* Reduces the economic burden on developers whose inclusionary obligation results in small fractions of units. Provides flexibility by allowing developers to produce the unit or pay an in-lieu fee.

*Disadvantages:* Fewer overall units will be produced.

#### **A-4. Threshold**

This provision determines to which developments the actual construction of inclusionary units pursuant to the Ordinance would apply. Because an inclusionary obligation may present insurmountable financial hardship on very small developments, the Ordinance should contain a threshold to exempt small developments from the inclusionary requirements. The following alternative thresholds have been presented and discussed.

- a) Developments with 5 or fewer units will be exempt from the Ordinance.

*Advantages:* This is a reasonable threshold, in that it is unlikely to be economically feasible for developments with fewer than 5 units to be able to comply with the Ordinance.

*Disadvantages:* This threshold may be too low. Developments with more than 5 units may also find it infeasible to comply with the Ordinance. It also may be administratively burdensome to implement.

- b) Developments with 10 or fewer units will be exempt from the Ordinance.

*Advantages:* This threshold is consistent with the current policy in RDA areas, proving that developments with 10 units can comply with the RDA's inclusionary obligation.

*Disadvantages:* If the threshold is set too high, the City may be missing an opportunity to produce more affordable units.

- c) Developments with 25 or fewer units will be exempt from the Ordinance.

*Advantages:* This threshold will reduce the financial impact on smaller developments.

*Disadvantages:* This threshold may be set too high, causing the City to miss an opportunity to produce more affordable units. Because many developments are on infill sites and are smaller than 25 units, this may result in fewer units being produced and may encourage lower-density development.

- d) Developments with 50 or fewer units will be exempt from the Ordinance.

*Advantages:* This threshold will reduce financial impact on smaller developments.

*Disadvantages:* This threshold may be set too high, causing the City to miss an opportunity to produce more affordable units. It may provide an incentive for developers to build smaller less dense developments. Because many developments are on infill sites and are smaller than 50 units, this may result in fewer units being produced and may encourage lower-density development.

#### **A-5. Term of Affordability**

This provision refers to the length of time affordable units produced under the Ordinance must remain affordable at the required income levels. The term of affordability may be different for homeownership and rental units. Redevelopment law requires a minimum term of 45 years for homeownership and 55 years for rental units.

- a) Shorter term: 30 years for rental and ownership units.

*Advantages:* A shorter term of affordability has less of an economic effect on developers.

*Disadvantages:* A 30 year term of affordability is not compliant with California Redevelopment Law. Units produced under the Ordinance will not be counted towards meeting the City's affordable housing production requirements. A shorter term of affordability does not provide for meeting future affordable housing needs.

- b) Medium term: 55 years for rental and 45 years for ownership units.

*Advantages:* A longer term of affordability maintains the City's stock of affordable housing to meet future housing needs. These terms meet minimum Redevelopment Law requirements and therefore units produced under the Ordinance will be counted towards the City's affordable housing production requirements.

*Disadvantages:* A longer term of affordability increases the economic effect on developers. A term of affordability that is not permanent does not provide for meeting future affordable housing needs.

- c) Long term: 99 years or permanent for rental and ownership units.

*Advantages:* A longer term of affordability maintains the City's stock of affordable housing to meet future housing needs. The units produced under the Ordinance will be counted towards the City's affordable housing production requirements.

*Disadvantages:* A longer term of affordability increases the economic effect on developers.

## **A-6. Type of Resale Restriction**

This issue refers to homeownership units only. It establishes the mechanism by which affordability of ownership units is maintained over time, as well as determines how an affordable unit can be resold when the initial buyer chooses to sell.

- a) Resale Restriction –the initial homeowner must resell the unit at a price that is affordable to a household at the same income level for which the unit was initially priced, adjusted for inflation. Subsequent buyers of the unit must be income eligible.

*Advantages:* This preserves the affordability of units produced under the Ordinance without necessarily requiring additional public subsidies in future years. Under this provision, assisted units will be preserved for the length of the term of affordability required in the Ordinance. The initial homeowner earns limited equity upon resale, based on the increase in AML.

*Disadvantages:* Resale restrictions focus on ensuring that a unit remains affordable, not that a first-time homebuyer has an opportunity to purchase a home. The owner earns limited equity upon resale, thus limiting the ability of homeownership to be an effective wealth accumulation strategy. If the affordable units are sold at a price that is too close to market price, it may be difficult to find buyers willing to agree to a resale restriction.

- b) Shared Equity – the initial homeowner can resell the unit at market price. The City recaptures the difference between the market sales price and the affordable purchase price of the unit, as well as a portion of the appreciation earned at resale. The City can then use these funds to subsidize a replacement affordable ownership unit.

*Advantages:* The owner earns more equity upon resale of the unit, thus this may be a successful wealth accumulation strategy. With shared equity rather than a resale restriction, it may be easier to find willing buyers for affordable units, even when they are priced close to the market price of comparable units. The funds captured from the sale of the unit can be used to assist another first-time homebuyer, who will have a choice of where he/she wants to live.

*Disadvantages:* This provision does not preserve the City's stock of affordable homeownership units over the long term.

## **A-7. Delayed Operative Date of Ordinance**

This issue establishes when the Ordinance will be implemented. Ordinances generally take effect 30 days after the final reading and adoption of the Ordinance by City Council.

- a) Ordinance should become operative one year after the effective date of the Ordinance by City Council.

*Advantages:* Including a date certain for the Ordinance to become operative provides certainty for developers and is easy to administer. A one year time period after effective date of the Ordinance may provide enough time for the market to recover from the current economic conditions. In addition, one year provides sufficient time for developers to adjust their financial and development assumptions to accommodate the Ordinance's requirements.

*Disadvantages:* A one year period after adoption of the Ordinance may not provide enough time for the market to recover from the existing economic condition and therefore may place more economic hardship on developers currently facing financial instability. A delayed effective date will result in fewer affordable units produced.

- b) Ordinance would be operative the later of (1) January 1, 2010 or (2) the first day of the month following the first 12 consecutive month period in which 2,000 building permits have been issued, as certified by the Housing Department Director or his/her designee.

*Advantages:* Historically, over the last 20 years, the number of permits has fallen under 2,000 permits three times and this correlates with down economic periods in the City. Should the market not be healthy in a year's time, this option would delay the implementation of the Ordinance until building permits have reached a reasonable level. However, if the market has recovered, the Ordinance would go into effect in January of 2010.

*Disadvantages:* By not adopting a date certain for operation of the Ordinance, this increases uncertainty for developers in planning future developments. Delaying the operation of the ordinance will result in fewer affordable units produced.

- c) Ordinance would be operative when the calendar year in which building permits for unsubsidized housing as at least equal to 50% of the number of permits for unsubsidized housing issued in a rolling average of the past ten years.

*Advantages:* Tying the effective date to building permit activity in the City may allow the market to recover before inclusionary requirements are operative. By only counting market-rate production, this is a better measure of economic recovery.

*Disadvantages:* Because this rolling production number is so low, it may not allow for sufficient time for the market to recover. A delayed effective date will result in fewer affordable housing units produced. This would be more difficult to administer because the permit tracking system does not distinguish between unsubsidized and affordable units.

#### **A-8. Grandfathering/Pipeline**

To impose new requirements on a developer who has already invested substantial time and resources into purchase, pre-development and planning for a development may increase the developer's costs and the uncertainty of the development process. For this reason, inclusionary

ordinances often exempt developments that are in the development pipeline from the inclusionary requirements. This provision specifies the step in the pre-development process that developments must have completed in order to qualify for this exemption. Establishing the cut-off point too early in the process will exempt developments that have completed initial planning but could still adjust to the inclusionary requirements without incurring high additional costs. Establishing the point too late in the development process can impose an unfair financial burden on developments that have invested sufficient resources into planning the project without inclusionary requirements.

In addition to establishing the cut-off point for the grandfathering provision, the Ordinance can require that developments that qualify for the exemption actually begin construction within a reasonable amount of time. This ensures that developments in the pipeline do not receive their exemption and then stall their construction timeline and delay building their units.

The grandfathering provision can exempt those projects that meet all of the following criteria on or before the Effective Date of the Ordinance:

- a) The developer has purchased land within one year prior to the adoption date and has submitted a preliminary review application to the City or has negotiated a purchase agreement within one year prior to the adoption date involving the payment of a substantial consideration to either the landowner or the City and has submitted a preliminary review application to the City.

*Advantages:* Ordinance would have no financial impact on developers that have already purchased land.

*Disadvantages:* This will be difficult to administer because the City can not efficiently or effectively monitor transactions in the private market. This alternative may exempt a large pipeline of projects, thus resulting in fewer affordable units produced. Without requiring the exempt developments to demonstrate continued progress toward completion, projects may be deemed exempt and then stall in building in order to escape inclusionary requirements.

- b) A landowner has owned the land for at least one year prior to the adoption date, has submitted a preliminary review application to the City, and submits an additional entitlement application within one year following the submittal of the preliminary application. The requirement for an additional entitlement application will be waived if the City prohibits submittal of such applications.

*Advantages:* Would exempt developers that have invested time and resources in land purchase, planning and predevelopment, thus promoting fairness for developers. This option requires demonstrated progress toward entitlement and permitting.

*Disadvantages:* This will be difficult to administer because the City can not efficiently or effectively monitor transactions in the private market. This alternative may exempt a

large pipeline of projects, thus resulting in fewer affordable units produced. The City does not have a mechanism for tracking private land transactions.

- c) The developer has submitted a “substantially complete application” for a planning permit.

*Advantages:* This alternative avoids placing new requirements on developments that have invested substantial time and resources into planning and pre-development, thus promoting fairness in the development process. It also provides for more certainty of costs and revenue for developments in the pipeline.

*Disadvantages:* Exempting these developments will result in fewer affordable units being produced. In addition, without requiring the exempt developments to demonstrate continued progress toward completion, projects may be deemed exempt and then stall in building in order to escape inclusionary requirements, thus resulting in fewer affordable units being produced.

- d) The developer has received a building permit before the Effective Date of the Ordinance.

*Advantages:* This alternative avoids placing new requirements on developments that have invested substantial time and resources into planning and pre-development, thus promoting fairness in the development process. It also provides for more certainty of costs and revenue for developments in the pipeline.

*Disadvantages:* This may be difficult to administer and monitor. Exempting these developments will result in fewer affordable units being produced. In addition, without requiring the exempt developments to demonstrate continued progress toward completion, projects may be deemed exempt and then stall in building in order to escape inclusionary requirements, thus resulting in fewer affordable units being produced.

- e) The developer meets one of the above requirements (a) and/or (b) and demonstrates that continued progress is made towards completion of the development. Continued progress is demonstrated by: a) receiving an approved planning permit (entitlement) within 18 months after the application filing and b) receiving an approved building permit within 24 months after applying for the planning permit.

*Advantages:* This alternative avoids placing new requirements on developments that have invested substantial time and resources into planning and pre-development, thus providing more certainty of costs and revenue for developments in the pipeline. It also ensures that only those developments that are legitimately in the process of being built are exempt from inclusionary requirements. This may result in fewer projects being exempt and more affordable units being produced. The requirement to demonstrate continued progress toward completion would also apply to exempt master planned developments. Those sections of exempt master planned developments that do not receive an approved building permit within one to two years of entitlement would lose their grandfather status. This ensures that large, master planned developments that have begun planning, but are delaying in starting construction must make progress towards

construction or comply with the inclusionary requirements. This may increase the number of affordable units produced.

*Disadvantages:* Administering this exemption and monitoring the exempt projects may increase the workload of the Housing and Planning Departments. Can require 24+ months before exemption from the inclusionary obligations is verified.

#### **A-9. Pressure Relief Valve**

This provision would waive elements of the inclusionary requirements in times of economic downturns to promote development during these times. The issues to consider in drafting this provision include determining when the pressure relief valve comes into effect, how long it lasts, and what manner of relief it will provide.

- a) The pressure relief valve will be activated when fewer than 2,000 building permits have been issued in any consecutive 12 month period.

*Advantages:* This allows the Ordinance to respond to periods of demonstrated economic distress in the development community.

*Disadvantages:* This mechanism may be difficult to administer. By its nature, it will be very difficult to anticipate this pressure relief valve being activated, thus it may increase uncertainty and unpredictability in the application of the Ordinance and in the development process in the City. It causes continuous uncertainty in the applicability of the Ordinance.

- b) The pressure relief valve will be activated for homeownership units only when the gap between a unit's market price and its affordable price for households in the lowest income category targeted by the homeownership provisions of the Ordinance is \$10,000 or less. When this occurs, the unit will still be required to be sold at the affordable price to an income-qualified household, but will not be required to carry an equity share and/or resale restriction provision. For this provision, "market price" will be defined as the price, within three months of the proposed date of sale of the affordable unit, of market-rate units actually sold in the same development that are comparable in bedroom count to the affordable unit.

*Advantages:* This allows the Ordinance to respond to periods of demonstrated and current home price declines and is easier to administer and monitor. Because it is difficult to sell units with resale restrictions when the affordable price approaches the market price of comparable units, this pressure relief valve will make it easier for developers to sell their affordable units, while still meeting the current demand for affordable homeownership units. This may reduce carrying costs for developers.

*Disadvantages:* By waiving the equity share and/or resale restriction requirement, the City loses its ability to collect funds upon the resale of the affordable unit, thus losing

funds that can be used to subsidize replacement affordable homeownership units, resulting in the loss over time of affordable homeownership units.

## **Part B: Alternative Compliance Options**

The Ordinance may stipulate that developers can only comply with their inclusionary requirements through building affordable units on the same site as their market-rate units or may offer developers alternatives to building the required affordable units on-site. Alternative compliance options may reduce the cost to the developer of complying with the inclusionary requirements. These options may be offered through the Ordinance by-right, only when specified conditions are met, or only upon approval of the Housing Department Director. The issues to consider in offering alternative compliance options include: should alternative compliance options be offered; if so, what options should be offered; under what conditions should developers be allowed to use the alternative compliance options; should the Housing Department Director's approval be required; and should developers be required to provide more affordable units if they choose to use an alternative compliance option.

- a) Developers are only allowed to comply with inclusionary requirements through building affordable units on-site.

*Advantages:* Affordable units will be dispersed within market-rate developments and economic integration of developments and neighborhoods will be achieved. Lower-income households will have more housing options throughout the City. Increases the simplicity of the Ordinance.

*Disadvantages:* May be a financial burden for developers, depending on the type of construction and characteristics of the site. Does not offer developers flexibility in complying with inclusionary requirements.

- b) Developers are allowed by-right to comply with inclusionary requirements through any alternative compliance option.

*Advantages:* Provides maximum flexibility for developers. May reduce the cost of compliance for developers.

*Disadvantages:* May result in fewer units being built on-site, thus the City may lose the opportunity to achieve economic integration of developments and neighborhoods. May result in developers choosing compliance options that do not require units to be produced, thus resulting in fewer affordable units. May cause the outcome of the Ordinance to be less predictable.

- c) Developers can use alternative compliance options when specified conditions are met and the approval of the Housing Department Director is granted.

*Advantages:* Provides flexibility for developers while ensuring that the Ordinance's goals are met. May reduce uncertainty and costs for some developers in complying with inclusionary requirements.

*Disadvantages:* More staff intensive to implement and less predictable for developers. May result in fewer affordable units being produced if many developers are allowed to comply through alternative compliance options that do not require the production of units. If many developers are allowed to comply by building affordable units off-site, the City may lose the opportunity to achieve economic integration of developments and neighborhoods.

#### **B-1. Off-site Construction**

- a) Developers can use the off-site construction alternative compliance option if it is demonstrated that another site would be a more appropriate site for affordable housing or if more units or deeper affordability would be achieved off-site. Approval for building off-site must be granted by the Housing Department Director.

*Advantages:* Provides flexibility for developers while ensuring that the Ordinance's goals are met. If the off-site land is less expensive, this option may reduce costs for some developers in complying with inclusionary requirements. It also may result in more affordable units being produced if developers opt for building off-site by offering more units or deeper affordability. Developers building off-site may be able to produce a different type of housing that is better suited for affordable housing than they would produce on-site. Developers can access State and federal funding to achieve this deeper affordability, something that wouldn't be possible if the units were integrated. By placing the burden of proof on the developer to demonstrate financial hardship, this provision may lead to less prevalent use of the off-site alternative compliance option, thus promoting economic integration of developments.

*Disadvantages:* The City loses the opportunity to achieve economic integration of developments and neighborhoods. It may be difficult to ensure that the affordable units are built at the same time as the market-rate units if the affordable units are built off-site. Building affordable units off-site may lead to in neighborhood opposition issues.

- b) Developers can use the off-site alternative compliance option by-right if they will partner with an experienced affordable housing developer. The Housing Department Director must approve the financing plan of the proposed affordable housing development. A more flexible timeline for building the affordable units may be permitted.

*Advantages:* Promotes partnerships between market-rate and affordable housing developers. May reduce the cost of providing the affordable housing units and allows for the leveraging of State and federal funds. Provides for more flexibility for developers in meeting their inclusionary obligations.

*Disadvantages:* By allowing by-right compliance through building affordable units off-site, the clustering of affordable housing may result and the City may lose the opportunity to achieve economic integration of developments and neighborhoods. Building affordable units off-site may lead to in neighborhood opposition issues.

- c) Developers using the off-site alternative compliance option are required to produce more affordable units than they would be required to produce on-site.

*Advantages:* Provides an incentive for building affordable units on-site, thus promoting economic integration. May result in more affordable units being produced, if the off-site option is used.

*Disadvantages:* May increase the cost of compliance for developers choosing to build the affordable units off-site.

## **B-2. Credit Trading**

This alternative compliance option allows developers to transfer credits of affordable units to other developers, thus allowing developers to pool their credits and meet their inclusionary obligations together in larger affordable developments.

- a) The developer is allowed to trade credits rather than build affordable units on-site, provided specified conditions are met and approval of the Housing Department Director is granted.

*Advantages:* Allowing credit transfers provides more flexibility for developers in meeting inclusionary obligations. If developers pool their credits and produce larger affordable developments, these projects may be more economically feasible and may represent lower cost of compliance for the developers. The resulting developments may be easier to manage than scattered affordable housing units.

*Disadvantages:* Allowing credit transfers may result in fewer affordable units produced on-site, thus the City may lose an opportunity to achieve economic integration of developments and neighborhoods. It also may be difficult to ensure that affordable units produced through credit transfers are produced at the same time as the market-rate units. Thus, the development of affordable units may be delayed.

### **b) Credit Transfer for Housing Preservation**

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 for no less than five years. This benefit is not transferable from the owner to another developer.

*Advantages:* This will incentivize owners of HUD-subsidized units to keep the units affordable for a longer period of time.

*Disadvantages:* Requiring that the expiring units are maintained for a five year period of affordability is only a short-term affordability restriction. This option will not create new units in the City, thus it will not help the City to meet the growing need for affordable housing.

### **B-3. In-Lieu Fee Option**

An in-lieu fee alternative compliance option allows the developer to pay a per-unit in-lieu fee rather than producing affordable units. The City can then use the funds collected through the in-lieu fee to subsidize future affordable housing projects. The in-lieu fee option can be offered by-right to all developers, can be allowed only if certain conditions are met, or can only be allowed in cases when a developer's inclusionary obligation results in a partial unit.

- a) The in-lieu fee option is offered by-right to all developers.

*Advantages:* An in-lieu fee provides for flexibility for developers in complying with inclusionary requirements and is easy to administer. Requiring developers to build affordable units on-site in low density developments may be an unfair economic burden on developers. For these developments, an in-lieu fee option may be more appropriate. If the amount of the in-lieu fee is less than the cost of providing the affordable unit, this will be a less costly compliance option for developers. If the amount of the in-lieu fee is equal to the cost of providing the affordable unit, the City will collect funds sufficient to provide the number of affordable units required by the Ordinance. The City can then target the uses of these funds to meet a variety of affordable housing goals.

*Disadvantages:* Allowing an in-lieu fee option by-right may not produce affordable units as quickly as requiring them to be built on-site. The City also may miss the opportunity to promote economic integration since fewer affordable units will be produced on-site. With the in-lieu fee, the City has the responsibility for providing the affordable units, including assembling the land and finding a developer. In addition, if the in-lieu fee amount is less than the cost of providing the affordable unit, the funds collected by the City will not be sufficient to produce the number of units that would otherwise be achieved through the Ordinance. Thus, fewer affordable units will be produced and/or additional City funds will be required to build the number of units that would otherwise be required by the Ordinance. If the in-lieu fee is set too low, it will always be selected, so possibilities for economic integration or nonprofit-partnerships will be eliminated.

- b) The in-lieu fee option is offered only in certain circumstances.

*Advantages:* This may provide for flexibility for developers while ensuring that the Ordinance's goals are met.

- c) The in-lieu fee option is allowed only when a developer's affordable housing obligation results in a partial unit.

*Advantages:* By allowing an in-lieu fee option only for partial units, more affordable units will be produced by developers, without the City's involvement. The City will collect some in-lieu fee revenue that can be used to fund affordable housing.

*Disadvantages:* Does not provide for flexibility for developers in meeting inclusionary requirements. The City will likely not collect sufficient funds to produce many units from an in-lieu fee on partial units only.

#### **B-4. In-Lieu Fee Amount**

The manner in which the per unit in-lieu fee is calculated will determine how widespread the use of this option is, how many units are produced through the Ordinance, and whether the fee revenue collected by the City will be sufficient to construct affordable units.

- a) The in-lieu fee will equal the average amount of public subsidy required to produce the affordable unit, assuming leveraged public financing is used.

*Advantages:* For some unit types, this would be a higher fee than is currently required under the RDA policy. Assuming public financing is secured, this fee amount may be sufficient to provide the number of units otherwise required through the Ordinance. Simple to administer and calculate.

*Disadvantages:* Unless the in-lieu fee is an amount at least equal to the affordability gap of the unit, the developer will always choose to pay the in-lieu fee rather than produce the unit. This will result in fewer affordable units produced and the City will not collect fee revenue that is sufficient to provide the affordable units otherwise required by the Ordinance.

- b) The in-lieu fee amount will equal the cost to construct the unit.

*Advantages:* This would likely be a higher fee than is currently required under the RDA policy. A fee amount equal to the cost of constructing the affordable unit will provide fee revenue to the City that will be sufficient to provide the number of units otherwise required through the Ordinance. Setting the in-lieu fee amount equal to the cost of constructing the unit may lead to more affordable units being built.

*Disadvantages:* Setting the in-lieu fee amount equal to the cost of constructing the unit may represent a financial hardship to the developer, potentially resulting in fewer in-lieu fee funds collected by the City.

- c) The in-lieu fee amount will equal the "affordability gap," the gap between the cost of constructing the unit and the revenue collected from selling or renting the unit at the affordable sales price or rent.

*Advantages:* This would likely be a higher fee than is currently required under the RdA policy. Unless the in-lieu fee is an amount at least equal to the affordability gap of the unit, the developer will always chose to pay the in-lieu fee rather than produce the unit. By setting the in-lieu fee equal to the affordability gap, more affordable units may be produced. In addition, the in-lieu fee revenue collected by the City will be sufficient to construct the number of units otherwise required by the Ordinance. Additional City funds will not be required.

- d) The in-lieu fee will be established at the following amounts:

Rental units	\$75,000
Condominium units	\$90,000
Townhomes	\$100,000
Single family detached	\$200,000
High Rise (not downtown)	\$200,000

*Advantages:* A set fee is easy to understand and administer.

*Disadvantages:* There is no rationale regarding how the fee is set and may be indefensible if disputed by the development community. The amount of the fee is insufficient to replace the on-site units for rental, condominium and townhome units.

#### **B-5. Land Dedication**

Under this alternative compliance option, developers can donate land to the City instead of building affordable units on-site. The issues to consider in drafting this provision include: translating the developer's inclusionary obligation into a required minimum value of land to be donated and determining the value of the donated land.

- a) Land dedication is not allowed as an alternative compliance option.

*Advantages:* More affordable units will be produced on-site, thus promoting economic integration of developments and neighborhoods.

*Disadvantages:* Provides less flexibility for developers in complying with inclusionary obligations. By not allowing land dedication in any case, the City may be missing an opportunity to receive developable land for future affordable housing projects.

- b) Land dedication is allowed as an alternative compliance option, per the approval of the Housing Department Director.

*Advantages:* Allowing land dedication in cases approved by the Housing Department Director may result in the City receiving land that can be used for future affordable housing projects. It also provides flexibility for developers in complying with inclusionary housing obligations.

*Disadvantages:* Allowing land dedication may result in fewer affordable units produced on-site, thus the City may lose the opportunity for achieving economic integration of developments and neighborhoods. Allowing land dedication will likely delay the construction of affordable units, may result in neighborhood opposition issues, and does not ensure that affordable units will be built. Additional public subsidy will likely be required to produce affordable units on land received through the land dedication option, as free land may be insufficient to subsidize the development of affordable units. With this option, the City may be responsible for ensuring that affordable housing is completed on the dedicated land and will also be responsible for the costs of holding and/or disposing of the land. If the value of the land is not equal to the cost to the developer of providing the affordable units, the developer will likely opt to donate the land.

#### **B-6. Acquisition / Acquisition & Rehabilitation**

This alternative compliance option allows developers to meet their inclusionary requirements by acquiring and rehabilitating market-rate units and converting them to affordable units. The issues to consider in drafting this provision include: what requirements should be placed on the acquired and rehabilitated units to ensure that they are comparable to the developer's on-site inclusionary obligation; should more units be required if developers choose this option; how can the City ensure that the units produced under this option are produced at the same time as the market-rate units; and should the inclusionary obligation under this option be calculated by bedroom count or by number of units.

- a) Developers should be allowed to comply with the inclusionary obligation through acquiring and rehabilitating units, provided specified conditions are met and approval of the Housing Department Director is granted.

*Advantages:* Allowing this option provides flexibility for developers in meeting inclusionary obligations and may provide a lower cost option for compliance. It also may promote partnerships between market rate and affordable housing developers. In reviewing requests for using this option and granting approval, the Housing Department Director can target acquisition and rehabilitation projects in certain geographic areas of the City, such as Strong Neighborhood Initiative areas or areas that are suffering from disinvestment. This may have revitalizing effects in these areas and may improve the City's deteriorating housing stock.

*Disadvantages:* Acquisition and rehabilitation projects may require public subsidies, thus resulting in fewer affordable units being produced without public subsidy. This option will not result in affordable units being provided on-site, thus the City may miss the opportunity to achieve economic integration of developments and neighborhoods. Acquisition and rehabilitation projects may lead to clustering of affordable housing and may result in neighborhood opposition issues. It may be difficult to ensure that acquired and rehabilitated units are produced at the same time as the market-rate units, thus resulting in a delay in production of affordable units. In addition, acquisition and rehabilitation projects may displace current tenants and may lead to relocation issues. Allowing acquisition/rehabilitation may be difficult to administer because standards will

have to be developed regarding what types of units will be acceptable for meeting the inclusionary obligation. Unit sizes may be different in the new market-rate development and the acquisition/rehabilitation project, thus resulting in smaller affordable units produced than would be if built on-site. Additionally, this option will not create new units in the City, thus it will not help the City to meet the growing need for affordable housing.

- b) The developer is allowed to comply with the Ordinance through acquisition and rehabilitation of market-rate units, provided that the total number of bedrooms in the resulting affordable units are equal to the total number of bedrooms contained in the affordable units that would be required if the developer complied by building the units on-site.

*Advantages:* Calculating a developer's inclusionary obligation for acquisition and rehabilitation units by bedroom count ensures that developers do not meet their inclusionary obligation under this option by providing smaller units than they would otherwise be required to provide on-site. This may produce more affordable units overall. It also may provide an incentive for developers to produce larger affordable units, thus helping to meet the City's need for affordable housing for families.

- c) 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.

*Advantages:* May provide an incentive for acquiring and rehabilitating market-rate units as affordable units. By offering a four-to-one credit, more affordable units will be produced.

## **B-7. Combination**

Combining alternative compliance options allows developers to meet their inclusionary obligations through any combination of the allowed alternative compliance options.

- a) The developer is allowed to combine any allowed alternative compliance options rather than build affordable units on-site, provided specified conditions are met and approval of the Housing Department Director is granted.

*Advantages:* Allowing combinations of alternative compliance options provides developers with maximum flexibility in meeting their inclusionary obligations. This may result in a reduced cost of compliance for developers. Through experience, staff has realized that sometimes it works best to allow for developers to meet their obligation through a variety of methods (such as building an off-site project that meets most of the obligation and paying a small in-lieu fee to meet the rest, or building VLI units offsite and integrating LI units on-site).

*Disadvantages:* Allowing combinations of alternative compliance options may be difficult to administer and monitor. Depending on which options are allowed to be combined, this may result in fewer affordable units produced through the Ordinance.

## **Part C: Offsets**

The Ordinance may include a series of incentives and offsets in order to reduce the cost to developers of producing the affordable units required. The potential offsets that the Ordinance can include are explained below.

### **C-1. Flexibility with Exterior Design Standards**

These offsets offer developers flexibility with the exterior design standards that apply to the affordable units.

- a) Developers will be provided with a density bonus equal to the percentage of the development's total units that are required to be affordable.

*Advantages:* By allowing developers to include more units in developments that provide affordable units on-site, the per-unit cost of the development may be reduced and the revenue the developer can generate with the market-rate units may be increased. This may provide an incentive for developers to build the affordable units on-site, thus achieving economic integration.

*Disadvantages:* Increasing the density of a development may be met with neighborhood resistance. In addition, due to market, neighborhood and design considerations, developers may not seek to increase the density of their developments, thus reducing the value of this offset. Increasing density may also have a fiscal impact on the City, as more housing units will increase the demand for City services.

- b) Developers will be provided with reduced parking requirement for the affordable units that are built on-site in proximity to transit and/or in combination with Encompasses or car sharing when made available to residents.

*Advantages:* Because of the high cost of constructing structured parking, this offset may substantially lower the cost of providing affordable units. This offset will not likely have a fiscal impact on the City.

*Disadvantages:* In neighborhoods where parking is already impacted, developers may not seek a reduced parking requirement, as fewer parking spaces may present marketing challenges for their units. When the reduced parking requirement offset is used, it may lead to impacted parking in neighborhoods and may be met with neighborhood resistance.

- c) Developers will be offered offsets for the affordable units including: reduced lot size and set back requirements, altered landscaping requirements, reduced minimum side yard requirements and reduced floor area ratio requirements.

*Advantages:* Altering these exterior design standards for affordable inclusionary units may reduce the cost of compliance for developers and will not likely have a fiscal impact on the City.

*Disadvantages:* Altering exterior design standards may raise neighborhood concerns. It also may result in affordable units that are visibly different from the market rate units in the same development.

## **C-2. Alternative Interior Design Standards / Alternative Product Type**

This set of potential offsets offer developers alternative interior design standards for affordable units as well as the option of providing affordable units that are a different product type than the market-rate units in the development, in order to reduce the cost of providing the affordable units.

- a) Developers of single family units can provide affordable units that are of a different product type on site. The bedroom count distribution of the affordable units must be comparable to that of the market rate units in the development.

*Advantages:* This offset provides developers with flexibility in meeting inclusionary requirements. It also reduces the per unit cost of construction for affordable units, thus offers developers a more cost effective way to comply with the Ordinance. The offset will not likely have a fiscal impact on the City.

*Disadvantages:* Providing affordable units that are a different product type than the market-rate units may not be feasible or desirable for all developments or sites, thus reducing the value of this offset to developers. If the product types of the affordable and market-rate units in a development are different and the affordable units are clustered together, this offset may create segregation within the development.

- b) The developer is allowed to provide alternative interior materials, appliances and/or design for the on-site affordable units.

*Advantages:* May reduce the per unit construction costs for the affordable units, thus reducing the cost of compliance for developers.

*Disadvantages:* For rental developments, it may be inconvenient and administratively prohibitive to offer different interior finishes for affordable and market-rate units, because the developer would not be able to easily substitute market-rate units for affordable units when tenants are no longer income eligible for the affordable units.

### **C-3. Deferral of Impact Fees**

Payment of impact fees is required prior to the issuance of a building permit. This offset would allow the developer to defer the payment of impact fees for the affordable units, thus reducing the up-front costs of the development as well as financing costs.

- a) The developer can delay payment of impact fees for the affordable units.

*Advantages:* Allowing delayed payment of impact fees for affordable units is consistent with current City policy and may reduce the cost to the developer of complying with inclusionary obligations.

*Disadvantages:* Requiring the payment of impact fees at different times for different units within the same development may be complicated to administer. Delaying payment of impact fees will have a fiscal impact on the City.

### **C-4. Expedited Review**

This offset is offered to developers who provide affordable units on-site. It provides for a shorter planning review process for these developments.

- a) The developer is offered an expedited review process that includes mutually agreed upon milestones for both the City and the developer, provided the affordable units are provided on-site.

*Advantages:* An expedited review process may provide more certainty for developers and may reduce development costs. This incentive may result in more affordable units being provided on-site, thus achieving economic integration.

*Disadvantages:* If many developers provide affordable units on-site, it may be difficult to provide them all with expedited review processes. This may result in the need for additional staff to effectively implement this offset. Because the review process is uncertain and it is difficult to achieve consensus on the "normal" process timeline, it may be difficult to achieve consensus on an expedited timeline.

### **C-5. Technical Assistance**

The Housing Departments can offer technical assistance to developers who will meet their inclusionary obligation by building affordable units on-site.

- a) Developers who provide affordable inclusionary units on-site will be offered technical assistance with the development review process, financing alternatives for affordable units, and assistance in selling or renting the affordable units.

*Advantages:* This incentive may lead to more affordable units being built on-site, thus increasing economic integration of developments and neighborhoods. The technical

assistance may allow developers to access financing for affordable units, thus reducing the cost or providing the affordable units.

*Disadvantages:* If all developers build the affordable units on-site and request technical assistance, this may result in significant demand for staff time in offering technical assistance.

#### **C-6. Ability to Obtain Federal, State and Locally-Controlled Funds**

Developers may be allowed or prohibited from accessing public funds to subsidize the development of the affordable units required under the Ordinance.

- a) The developer is allowed to apply for any financial subsidy to finance the development of the affordable inclusionary units.

*Advantages:* Allowing financial subsidy reduces the cost to the developer of providing the affordable units. Makes it easier to achieve greater affordability.

*Disadvantages:* Allowing developers to apply for public financing for the inclusionary units puts those units in competition with other affordable developments for limited funds. This may reduce the funds available for other affordable housing developments in the City.

- b) The developer should not be allowed to apply for any public financial subsidy for the required inclusionary units.

*Advantages:* This preserves public funds for other affordable housing projects in the City.

*Disadvantages:* This does not provide developers with the opportunity to reduce the economic effect of the inclusionary requirement.

- c) The developer is not permitted to access federal and State financing and is only allowed to obtain local subsidies if deeper affordability is achieved or more affordable units are provided than is required under the Ordinance.

*Advantages:* This provides incentive for developers to improve the affordability or increase the number of affordable units they provide while preserving public funds for other affordable housing projects in the City. This may lead to more affordable units being produced or more units targeted at lower income levels.

*Disadvantages:* This does not provide all developers with the opportunity to reduce the economic effect of the inclusionary requirement.

## **Part D: Offsets Currently Offered to Developments that Include Affordable Units**

The following fee exemptions and waivers are currently offered to rental developments that include affordable units. Developments that comply with the Ordinance by building affordable units on-site and meet the requirements detailed below will be eligible for the exemptions and waivers.

### **D-1. Park Fee Exemption**

This offset applies to developments that include affordable units targeted to households earning less than 60 percent of AMI.

### **D-2. Property Tax Exemption**

This offset applies to rental developers who partner with a nonprofit developer that is a certified 501(c)(3) organization and who provide units that are affordable to households earning less than 80 percent of AMI. To qualify for this exemption, the managing general partner must be a nonprofit as defined in the California Revenue and Taxation Code Section 214 and must have "material participation" and "substantial management duties" in the project, as defined in the California Board of Equalization Rule 140.1.

### **D-3. Construction Tax Exemption**

This offset applies to rental developments that provide units that are affordable to households earning 50 percent of AMI or below. Eligible developments can be exempt from the following construction taxes: Building and Structure Construction Tax, construction portion of the Construction and Conveyance Tax, Commercial-Residential Mobilehome Park Building Tax, and Residential Construction Tax.