



Memorandum

TO: COMMUNITY AND ECONOMIC
DEVELOPMENT COMMITTEE

FROM: Leslye Krutko

SUBJECT: SEE BELOW
REPLACEMENT MEMO

DATE: April 12, 2010

Approved

Date

4-21-10

**SUBJECT: REVIEW THE CITY'S POLICY OF TAX SUSPENSIONS FOR
AFFORDABLE HOUSING (REPLACEMENT MEMO)**

RECOMMENDATION

It is recommended that the Community and Economic Development Committee (CEDC) accept this report reviewing the City's policy that exempts affordable housing from the payment of certain fees and taxes, as directed by the City Council during its December 9, 2008 discussion of an inclusionary housing policy.

BACKGROUND

On December 9, 2008, when the City Council gave direction to staff to prepare a citywide inclusionary housing ordinance, staff was also asked to provide information on a number of policy issues. One of these follow up requests was to come back to the Council with a review of the City's policy that exempts affordable housing from the payment of certain fees and taxes.

The City Municipal Code, Chapters 4.46.039.5, 4.47.092, 4.54.038, and 4.64.035 of Title 4, grants a suspension of the following taxes to newly-constructed housing restricted to occupancy by very low-income households: the Building and Structure Construction Tax, the Construction Portion of the Construction and Conveyance Tax, the Commercial-Residential Mobilehome Park Building Tax (CRMP); and the Residential Construction Tax.

This policy has been in place for nearly 20 years. First discussed in the Mayor's Task Force Report of 1988, the City Council first approved a five-year suspension of very low-income housing from construction-related taxes in 1991 based on the magnitude of the City's affordable housing needs and recognition of affordable housing production as a critical priority in the City's effort to increase the quality of life for all San José residents, especially for those earning very low-incomes. Since 1991, the City Council has extended the tax suspension three times - in 1996, 2001, and 2006 - with each extension lasting for five years. The most recent suspension is set to expire on June 30, 2011.

The suspension only applies to very low-income units subject to affordability restrictions. For the purposes of the ordinance, very low-income housing is defined as housing affordable to households whose incomes do not exceed the qualifying limits for very low-income households as established, and occasionally amended, by the California Health and Safety Code. Currently this limit is defined as 0-50% of Area Median Income by household size. Housing affordable to extremely low-income households falls within the definition of very low-income for purposes of the ordinance.

In San José, a household of two is considered very low income if their combined income is \$42,450 or less annually, while a household of four would be considered very low income if their annual income was \$53,050. The community relies on those workers whose wages, if not combined with another household member, puts their household within the very low-income category – Nurse LPN (\$49,031), Janitor (\$30,166), and Retail Salesperson (\$27,375). Furthermore, many City staff, who ensure the government runs smoothly, have annual salaries that, without assistance from other household members, would place their family within the very low-income category – Accountant Clerk 1 (\$47,548), Custodian (\$47,986), and Council Assistant (\$47,677).¹

Historically, the City has provided tax and fee exemptions to entice businesses to move to San José or build specific types of developments in the City. Examples of developments receiving such exemptions include buildings constructed for lease to the County for multi-service centers; construction in the Park Center, San Antonio Plaza, Pueblo Uno, and Julian-Stockton redevelopment project areas; and construction designed or intended to be solely for religious worship or religiously owned schools (see Attachment A for additional details). As recently as February 2010, the City Council directed staff to consider the feasibility of development incentives, including waiving license fees for new small businesses fees on parking leases for businesses that enter into or renew a lease in a downtown office or commercial retail building; and deferring impact fees for housing, commercial, and industrial developers.²

Existing Construction-Related Taxes in San Jose

The City of San Jose imposes four development or construction impact taxes on new developments:

- **Construction Tax**, San Jose Municipal Code (SJMC) Chapter 4.54;
- **Residential Construction Tax**, SJMC Chapter 4.64;
- **Building and Structure Construction Tax**, SJMC Chapter 4.46; and
- **Commercial-Residential-Mobilehome Park Building Tax** SJMC Chapter 4.47.

¹ Annual salaries for City staff are based on the top step in the job classification.
<http://www.sanjoseca.gov/humanResources/PayPlan.asp>

² San José City Council memorandum, Council Study Session 2/8/10, Subject: Development Incentives for San José's Economic Recovery.

These taxes are collected at the time of building permit issuance to finance transportation or other capital programs.

ANALYSIS

The issue of City construction tax suspensions for certain programs and/or targeted groups, in this case housing affordable to very low-income households, is a difficult policy issue for the City Council, especially during these economic times. In San José, the issue is a choice between contributing to the affordability of housing and other priorities. On one hand, the four taxes referenced above represent revenue sources which could be used by several City departments to partially defray the costs of capital improvement and maintenance of projects, such as transportation and traffic, public library, fire protection, parks and recreation, and communication facilities. On the other hand, these same taxes have been identified as one of several cost factors that, when combined with other development-related fees and taxes, contribute to making housing unaffordable to many City residents, especially those that earn very low incomes.

Cost and Benefits/Impacts Issues

The City relies on construction tax suspensions as a means of demonstrating the City's efforts to remove barriers to affordable housing. The 2010-2015 draft Consolidated Plan, which the City Council will consider for final approval on May 4, 2010, discusses the constraint that these fees put on new housing production, while also providing for adequate planning services and maintenance of public services and facilities. These exemptions are also discussed in the City's 2007-2014 Housing Element Update as follows: "These exemption provisions reflect the City's sensitivity to the economic constraints experienced by developers supporting housing in higher-risk areas and housing for Very-Low Income households."³

The construction tax suspensions for affordable housing developments increases the City's ability to access additional State and federal funds for affordable housing. Some State funding applications, such as for BEGIN funds, provide additional points if applicants demonstrate efforts to remove regulatory barriers to affordable housing. The construction tax suspensions also demonstrate a local match when applying for federal funding, such as the HOME program. In accordance with HUD's requirements, the City of San José provides a 25% match for HOME funds, including in the form of tax and fee waivers. In Fiscal Year 2010-11 the City anticipates receiving \$4,694,689 in HOME funds.

In Fiscal Years 1991 to the present, the 8,463 affordable housing units targeted to Very Low- and Extremely-Low Income households resulted in approximately \$20,180,259 being suspended in construction fees and taxes, for an average savings of \$2,385 per unit. (See Table 1 for details) However, the lost revenues from the fees' suspension is more than compensated for by the fees collected from the City's development of other affordable housing units, most of which were integrated into the same projects as the units that received the tax suspension. From 1992 to the

³ San Jose Housing Element Update 2007-2014, Adopted June 16, 2009, pg. C61

present, the construction of new affordable housing resulted in an increase of approximately \$31,971,816 to the City's budget for units that were not subject to the suspension. The tax suspensions also provided indirect benefits to the City's economy in the form of additional sales taxes and construction jobs created by the affordable housing developments.

Table 1: Construction Tax Suspensions, Actual Fiscal Impact

Projects & Units	July 1991 – June 1996	July 1996 – June 2001	July 2001 – June 2006	July 2006 – Present	Totals
# of units (VLI Housing)	1,570	2,754	2,320	1,819	8,463
Tax Suspensions (VLI Housing)					
B&SC Tax	\$1,255,528	\$1,982,572	\$1,843,956	\$1,445,759	\$ 6,527,815
CRMP Tax	\$1,973,001	\$3,115,471	\$3,987,588	\$3,126,479	\$12,202,539
Construction Tax	\$ 113,230	\$ 206,550	\$ 187,005	\$146,629	\$ 653,414
Residential Construction Tax	\$ 141,840	\$ 247,860	\$ 228,020	\$178,771	\$ 796,491
Total Suspensions	\$3,483,599	\$5,552,453	\$6,246,569	\$4,897,638	\$20,180,259
Savings/Low-Income Unit	\$2,219	\$2,016	\$2,692	\$2,692	\$2,335
Taxes Paid (LI/MOD Units)					
Taxes paid	\$6,001,110	\$7,551,743	\$10,294,925	\$7,804,320	\$31,652,098

Over the last nineteen years, affordable housing developments have received \$20 million in tax suspensions; however, it is only one of the many activities eligible for these tax exemptions. During the four years from FY 2004-2005 to FY 2007-2008, the City provided a total of \$43 million in development impact tax exemptions for eligible activities, per City ordinance, including construction in downtown enterprise zones, core, and frame areas; solar building service equipment; small businesses; and housing affordable to very low-income households.⁴ Of the \$43 million the City provided in development impact tax exemptions from FY 2004-2005 to FY 2007-2008, just \$5.5 million was due to the very low income affordable housing exemption. During that same period, affordable housing not subject to the exemptions paid almost \$7 million in construction taxes to the City.

⁴ San Jose City Council Information Memorandum, March 17, 2009, Subject: Construction Tax Suspensions

Housing Needs

The City Council's decision in 1992, 1996, 2001, and 2006 to exempt housing restricted to occupancy by very low-income households from the construction-related taxes was based on the magnitude of the City's housing needs. The decision was also made in recognition of affordable housing production as a critical priority in the City's effort to increase the quality of life for all City residents, especially for those earning very low-incomes. Since 1992, the City has helped develop almost 20,000 affordable housing units. However, despite the City's efforts, affordable housing needs, especially for very low-income residents, remain a critical priority. Currently, over 20% of San José's households fall into the very low-income category.

Programmatic Needs and Issues

Affordable housing development in San José is financially feasible only because local housing funds are used to fill the project's "financing gap". Without the City's financing assistance, it is improbable that affordable housing in San José could be developed. Therefore, the argument that tax suspensions represent foregone revenues to other City programs is hypothetical, at best, because the collection of construction taxes depends on the actual construction of the affordable housing project. The suspensions also serve to stimulate affordable housing production. If the suspensions were eliminated, the construction taxes would be added directly to the project cost, increasing the "financing gap" that the City would need to subsidize. Currently, because of the SERAF payment and the decline in tax increment, the City's ability to fill "financing gaps" is even more limited, making the fee and tax suspensions that much more critical to getting new affordable housing built.

Finally, affordable housing is expensive to build due to higher labor costs; if there are two identical developments – one affordable and one market rate- the affordable housing would be more expensive to build. For example, all affordable housing developers provided City funding must pay its workers prevailing wage. Prevailing wage can easily add 20% to a development's labor costs, and up to 25% in times of decreasing labor costs such as during the current economic downturn.

I will be available at the April 26th Community and Economic Development Committee meeting to answer any additional questions.

/s/

LESLYE KRUTKO
Director, Housing Department

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

Attachments (1)