CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: SEE BELOW

DATE: November 6, 2014

Approved

Date 11/7/14

SUBJECT: ADOPTION OF A RESOLUTION OR APPROVAL OF AN ORDINANCE ESTABLISHING A HOUSING IMPACT FEE PROGRAM

RECOMMENDATION

It is recommended that the City Council:

(1) Hold a public hearing regarding the establishment of a Housing Impact Fee on new market-rate rental housing developments to address the need for affordable housing associated with such new development;

(2) Accept the Expenditure Plan prepared by staff and the "Residential Nexus Analysis – San Jose, California" dated October 2014 and prepared by Keyser Marston Associates, Inc.; and

(3) Establish a housing impact fee on new market-rate rental housing development, in order to increase the supply of affordable housing, by either:

a. Adopting a resolution to establish the Housing Impact Fee Program; or

b. Approving an ordinance adding Chapter 14.34 to Title 14 of the San José Municipal Code to establish the Housing Impact Fee Program.

OUTCOME

Approval of the recommended action will provide the City with a source of revenue with which to address the demand for affordable housing connected with new market rate development and will result in the development of new housing affordable to extremely low-, very low-, low-, and moderate-income households and individuals.

EXECUTIVE SUMMARY

In March of 2013, the City Council directed City staff to complete a nexus study for a potential Housing Impact Fee and to return to the City Council with a recommendation for action. Due to reductions in available affordable housing resources, the Council's direction was based on the desire to identify a revenue source that would enable the City of San Jose to continue to finance the development of housing affordable to lower- and moderate-income households. After completion of the nexus study and public outreach, the Housing Department is recommending that the City Council approve a resolution establishing a Housing Impact Fee of $17 per net rentable square foot to be levied on new, market-rate rental housing developments that are completed after July 1, 2016 except for certain pipeline projects that qualify for an exemption from the requirement. The imposition of a Housing Impact Fee is authorized pursuant to Section 200 of the City Charter and Section 7, Article XI of the California Constitution as a police powers measure to improve the public welfare of the City of San José. This recommendation to adopt this specific Housing Impact Fee is based on a Residential Nexus Analysis prepared by Keyser Marston Associates, Inc. (see Attachment 1) and information in this memorandum that establishes a reasonable relationship between the development of market-rate rental housing and the increased need for affordable housing. As discussed in the body of this report, all the findings required by the Mitigation Fee Act are supported by evidence presented in the Nexus Study and in this memorandum, the Expenditure Plan (see Attachment 3). The recommendation regarding the fee level and pipeline process is based on the outreach conducted by staff and the "Supplement to the Residential Nexus Analysis" dated October 2014 and prepared by Keyser Marston Associates, Inc ("Supplement") evaluating feasibility of various fee levels (see Attachment 2). It is anticipated that the Impact Fee would have a marginal, if any, effect on market-rate rents.

BACKGROUND

In recent years, housing costs have escalated sharply, increasing faster than incomes for many San Jose households. Rental housing in San José has become steadily more expensive. In the aftermath of the recent recession, RealFacts reports that average rents in San Jose have increased by 49% in the four years since 2010 (using third quarter data for both 2010 and 2014). In the last year alone, average rents have increased by 10.7% to $2,230/month. Currently, average rents range from $2,026 for a one-bedroom apartment to $3,028 for a three-bedroom/two-bath unit Citywide. There are also geographic disparities; rents in the 95134 zip code in North San Jose average $2,689 and those in the Downtown 95113 zip code average $2,920.

As a result, there is an existing, severe shortage of adequate, affordable housing for extremely low-, very low-, low-income (collectively, "lower-income"), and moderate-income households, The deficit is estimated at 16,315 units as of December 31, 2013 as determined in the annual update to the General Plan Housing Element, thus there is no excess supply of affordable housing in the City. In addition to that existing deficit, the City's Regional Housing Needs Allocation (RHNA) for period between January 1, 2014 and October 31, 2022 identifies the need to plan for 20,849 new affordable housing units.

Due to legal challenges to inclusionary rental housing programs, many cities across California have adopted impact fees to help address the impact of rental housing developments on the need for affordable housing development. A list of jurisdictions that have adopted or are considering such an impact fee is included in Part B of Attachment 3.

Chronology

In November 2012, in response to concerns about affordable housing funding in the aftermath of redevelopment dissolution, the City Council held a Study Session on Affordable Housing at which the Housing Department presented a number of funding alternatives to finance the production of affordable housing. At the conclusion of the Study Session, staff was directed to investigate a Housing Impact Fee.

At its March 12, 2013 meeting, the City Council directed staff to scope a "nexus analysis" necessary for the adoption of a housing impact fee. In June 2013, the Council directed staff to initiate such a nexus analysis.

In July 2013, after a competitive process, Keyser Marston Associates, Inc. (KMA) was selected as the consultant to prepare the nexus analysis. KMA's draft Nexus Analysis, which included consideration of an impact fee on both market-rate ownership and market-rate rental housing developments, was released to the public in September 2013. From late-September through early-November, staff conducted a number of outreach meetings to discuss that draft Nexus Analysis with developers, affordable housing advocates, and the general public.

During the outreach meetings, it became clear to staff that including for-sale residential developments in the Nexus Analysis was confusing since the City's Inclusionary Housing Ordinance (currently suspended due to a legal challenge) already addressed ownership housing projects. As a result, staff directed KMA to revise the Nexus Analysis to address a fee only on market-rate rental housing developments. Staff took the opportunity presented by this revision to revise the Nexus Analysis in two important ways: (1) recognizing that the San Jose market is much different than California as a whole, staff requested KMA to adjust the analysis method so that it could use Santa Clara County data (instead of Statewide data) on disposable income and spending patterns to ensure that the analysis considered local market conditions; and (2) use more up-to-date data that was not available when the September 2013 draft was being prepared.

On July 1, 2014, the June 2014 draft of the "Residential Nexus Analysis, San Jose, California" and the "Supplement to the Residential Nexus Analysis" – both prepared by KMA and incorporating the revisions noted above – were released to the public, followed by a 90-day review period during which staff participated in a series of public outreach meetings.

Following the 90-day public review period, the Nexus Analysis and Supplement were revised to address comments received and were finalized in October 2014 (see Attachments 1 and 2). The primary changes made to the Nexus and Supplement in response to these comments (see Part D of Attachment 3) were:

- The addition of graphics to illustrate certain points in the Analysis;
- An expanded discussion of the conservative nature of the assumptions used in the Analysis; and
- The addition of two more examples of the "level of impact" on market-rate housing should a housing impact fee be approved without a grandfathering provision.

The public comments were helpful in framing the recommended program design discussed later in this memorandum.

Staff has complied with the noticing and publication requirements of the Mitigation Fee Act prior to this meeting. Staff confirmed with the City Clerk's office that no requests for 14 day mailed notice were on file. Notice of the hearing was published twice in the newspaper consistent with the requirements of Government Code Section 6062a. At least 10 days prior to the hearing, the data indicating the estimated cost required to provide the service for which the fee is levied and the revenue sources anticipated to provide the service was made available to the public by providing copies of the Nexus Analysis and Expenditure Plan for review in the Clerk's office.

Council Actions

Under the Mitigation Fee Act, an impact fee may be established by fee or by resolution. At the request of the Mayor, both a resolution and an ordinance are presented for consideration in connection with this item. The resolution presented may be adopted on a single reading, but does not establish a chapter in the Municipal Code. The ordinance presented would establish a Chapter 14.34 in the San Jose Municipal Code. If passed for publication, the ordinance would need to be adopted upon a second reading, which would occur no sooner than December 2, 2014. Under either option, the effective date for the legislation would be 60 days after adoption.

ANALYSIS

According to the most recent Regional Housing Needs Allocation projections for the 8.8 year Projection Period from Jan 1, 2014-October 31,2022 published by the California Department of Finance and the Bay Area Association of Governments, the City will grow at an annualized rate of 3,986 households per year, with 1,617 of these new households being above 120% Area Median Income (AMI).

The need for affordable housing will increase as future population growth increases demand for goods and services leads to greater numbers of lower- and moderate-income jobs providing those goods and services. The City does not have sufficient funding to fully address these future affordable housing needs. The demand for affordable housing needs associated with new residential ownership developments are addressed by the City's inclusionary ordinance (currently suspended) and the City's inclusionary policy. The proposed Housing Impact Fee will provide the City with a source of revenue to assist with funding the development of affordable housing associated with new rental development.

The Expenditure Plan for the Housing Impact Fee (see Part C of Attachment 3) describes more specifically how the Fee would be used. This expenditure plan will be updated annually consistent with the requirements of the Mitigation Fee Act.

Mitigation Fee Act Consistency

Under the Mitigation Fee Act, local legislation imposing a development impact fee must identify the purpose of the fee, identify the use to which the fee is to be put, and be supported by determinations of the legislative body which determine that there is a reasonable relationship between the type of development project on which the fee is imposed and both (a) the fee's use and (b) the need for the public facility.

The purpose of the fee is to address the demand for affordable housing generated by increased spending for goods and services associated with new residential rental housing in the City. The purpose of the fee is also to implement the goals and objectives of the City's General Plan and the underlying State housing policies by facilitating the following: the development of housing affordable to a broad range of households with varying incomes within the City; making at least 15% of new housing affordable; providing safe, affordable housing for workers in resident-serving industries; and reducing the potential impacts on the environment by enabling the provision of such affordable housing in the City.

The Housing Impact Fee shall be used, consistent with the Expenditure Plan, as amended from time to time, to increase the supply of affordable housing in the City, including acquisition, construction, and development of affordable housing, acquisition and development of Housing Facilities, and any necessary and reasonable costs for administering the Housing Impact Fee Fund. Housing Facilities include (a) property acquired or proposed for acquisition by the City for affordable housing purposes and any improvements constructed thereon and (b) recorded affordability restrictions made for the benefit of and enforceable by the City.

The Nexus Study and the Expenditure Plan establish a reasonable relationship between: (a) the use of the Housing Impact Fee to create affordable housing to mitigate the increased demand for new affordable housing; and (b) new market rate residential rental developments. There is a reasonable relationship because new market rate residential rental development leads to new residents and the spending by these new residents leads to an increase in jobs, and due to the increase in jobs, new housing will be needed, including new housing affordable to extremely low-, very low-, low-, and moderate income households, which the Housing Impact Fee is intended to help provide by funding the construction of affordable housing and the acquisition of affordability covenants. The Nexus Study also establishes a reasonable relationship between the need for affordable housing units and new market rate rental residential development. This is so because new market rate residential rental development leads to a net increase in new residents, and the increase in goods and services required by these new residents leads to an increase in job creation in the City, including jobs in the service and retail sectors (e.g., teachers, restaurant workers, pet care, maintenance workers, etc.) with wages that will not allow these workers to obtain market rate housing. This results in an increase in the need for new housing affordable to extremely low-, very low-, low-, and moderate income households, which the Housing Impact Fee will be used to help provide.

Implementation of the General Plan Goals and Policies

The City's Envision San José 2040 General Plan recognizes that affordable housing is a critical component to the City's economic and social health. Establishing a Housing Impact Fee Program to finance affordable housing production is consistent with and will implement the General Plan's Housing goals and policies for affordable housing (listed in the Policy Alignment section of this memorandum), which include the following:

- Facilitating the provision of housing across location, type, price and status as rental or ownership that respond to the needs of all economic and demographic segments of the community (Policy #H-1.2).
- Encourage purchase assistance programs for "starter" housing (Policy #H-1.6).
- Facilitate the production of extremely low-, very low-, low-, and moderate-income housing by maximum use of resources at the federal, state and local levels (Policy #H-2.1).

The City's General Plan policies include the provision of affordable moderate income housing (H-2.1) and encouragement of purchase assistance programs for starter housing (H1.6). The City's Housing Department has always funded moderate income affordable housing as ownership housing (typically through a first time homebuyer program) because market-rate rental units have not typically required subsidy to be affordable to moderate-income households and the City has always encouraged homeownership.

Providing affordable housing for new employees in lower- and moderate-income jobs locally (rather than leaving those employees to obtain housing in lower cost areas far from San Jose employment centers and transit corridors) helps implement the General Plan policy aimed at minimizing housing's contribution to greenhouse gas emissions and locating housing to reduce vehicle miles traveled and auto dependency. If the increased demand for affordable housing is not addressed within San José it will cause such housing to be built elsewhere, in areas with lower land values that are far from City employment centers and transit corridors, and the resulting commuting will cause increased traffic and transit demands and consequent noise and air pollution.

If the increased demand for affordable housing is not addressed within San José it may also impact economic growth in that businesses within the City may find it more difficult to attract and retain the variety of workers that they need. This impact is also addressed in two of the new policies described below.

A Housing Impact Fee will also implement policies contained in Text Amendments to the Plan that the City Council will consider concurrently with consideration of the Housing Impact Fee (in a ~~deletions~~/additions format):

- ~~Increase, preserve and improve San Jose's affordable housing stock.~~ Preserve and improve San Jose's existing affordable housing stock and increase its supply such that 15% of all new housing stock developed is affordable to low-, very low-, and extremely low-income households.
- Facilitate the production of affordable and safe housing for workers who provide goods and services to San Jose residents and businesses.
- Facilitate housing that is affordable to those employed in population-serving, business-support, and driving industries.

Implementation of State Policies

In addition to locally adopted policies, development of affordable housing using Housing Impact Fee Program revenues to increase the supply of affordable housing implements policies of the State of California to: (1) provide sufficient capacity for new housing affordable at all income levels necessary to accommodate the State's future economic growth; and (2) by providing housing for lower- and moderate-income retail and service workers, long commutes from less expensive housing markets can be avoided and thus contribute to the implementing the Global Warming Solutions Act of 2006 and the Sustainable Communities and Climate Protection Act of 2008.

State housing policy requires the City to assist in the development of adequate housing to meet the needs of low and moderate income households. As discussed above there is a significant shortage of housing affordable to low and moderate income households, which will only increase as the finite number of residentially zoned lots within the City are purchased and developed for market rate residential developments. This loss of residential land available for affordable housing is another impact of market rate residential development.

Targeting Market-Rate Rental Housing for the Impact Fee

There are types of development which, although their development may be associated with a need for affordable housing are not proposed to be subject to the Housing Impact Fee. Market-rate ownership housing development is already subject to requirements to provide affordable units under the City's inclusionary housing programs. Imposing the fee on non-residential development is inconsistent with the General Plan's priority on job creation and economic development leading to a fiscally stronger community, so no such impact fee is proposed at this time. Although residents of affordable rental housing projects spend monies (albeit a lesser amount) that create jobs just like residents of market rate rental housing projects, these affordable projects create the housing that tends to address its own impacts due to its affordable nature. Moreover, the financing gap shown for affordable housing in the Nexus Analysis would be increased by the imposition of such a fee thus increasing the amount of City subsidy required, potentially resulting in no net production of new units.

<u>The Residential Nexus Analysis Methodology</u>

The Nexus Analysis demonstrates and quantifies the impact of new market-rate housing development on the demand for affordable housing.

The Nexus Analysis follows a logical chain of steps:

- New market-rate housing development accommodates population growth and that construction of this housing represents net new households.
- These new households create demand for goods and services which leads to the creation additional jobs. The expenditures by the new households include goods and services such as: food in grocery stores and restaurants; transportation (gas and/or transit); clothing and other goods at retail stores; hair care; care and feeding of pets; movies and other entertainment; dry cleaning and laundry services; and medical and dental services.
- The demand for these goods and services translates to jobs in a range of different compensation levels. The lower paid employees cannot afford market-rate apartments in San Jose and therefore the demand for already scarce affordable housing increases. The maximum amount of the impact fee is determined by the amount of subsidy needed to provide housing to these low-wage workers.

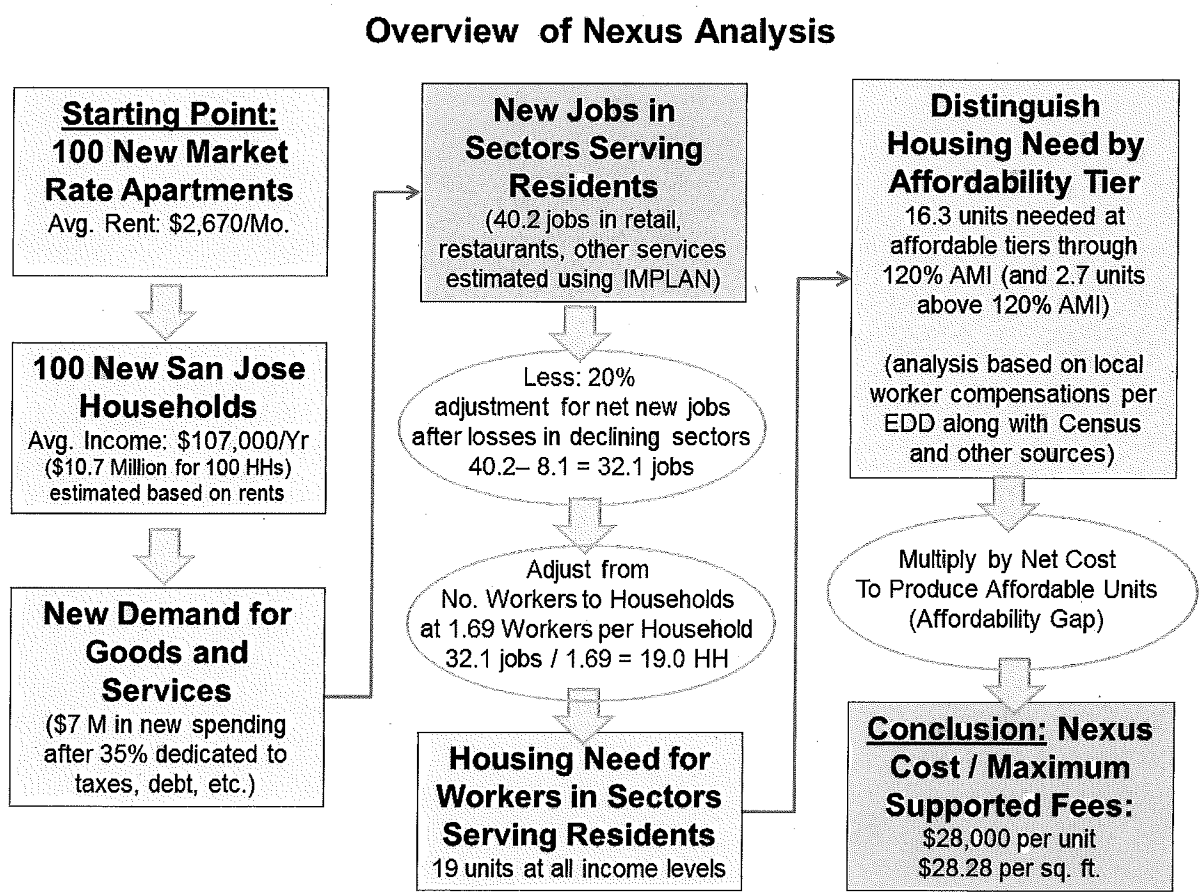
KMA developed a nexus model to estimate the demand for affordable housing generated by new market-rate rental apartments to put numbers to the steps outlined above:

- The first step of the nexus analysis was to identify the rental prototypes of what is being built in San Jose. Based on feedback from the Department of Planning, Building, and Code Enforcement, two prototypes were selected-- a low-rise rental apartment building and a high-rise development.
- The second step was to conduct a market survey to obtain the rent levels collected by each building type. The survey was conducted in the summer of 2013. Since the time the survey was conducted, rents have increased by 9% - 10%.
- Next, the model calculates the household incomes of the residents inhabiting the new market-rate apartments based on the assumption that 30% of their income is spent on rent.
- Then, the IMPLAN model was applied to link the housing income and spending power of residents in new market rate apartments to job growth occurring in Santa Clara County. IMPLAN provides the number of jobs by industry. (The IMPLAN model is commonly used by variety of public and private entities to provide projections of local economic

impacts of everything from baseball stadiums to employment growth; for a complete explanation of the model, see pages 1 and 51 in Attachment 1.)

- Local compensation levels and household sizes are then applied in order to convert the number of new jobs into the number of new worker households by income level by five income categories: Extremely Low (under 30% of the AMI); Very Low (30% to 50% of AMI); Low (50% to 80% of AMI); Moderate (80% to 120%); and Above Moderate (120+% of AMI. New households earning less than 120% were found to have a housing need because they could not afford new market-rate housing in San Jose.
- The demand for affordable housing is then multiplied by the net subsidy required (after tax credit financing is taken into account) to provide affordable units to the new worker households, resulting in the maximum allowable fee. The maximum fee established by the nexus analysis is $28.28 per square foot for an apartment and $27.78 per square foot for a High-rise apartment.

The following flow diagram illustrates the steps taken in the Nexus Analysis:



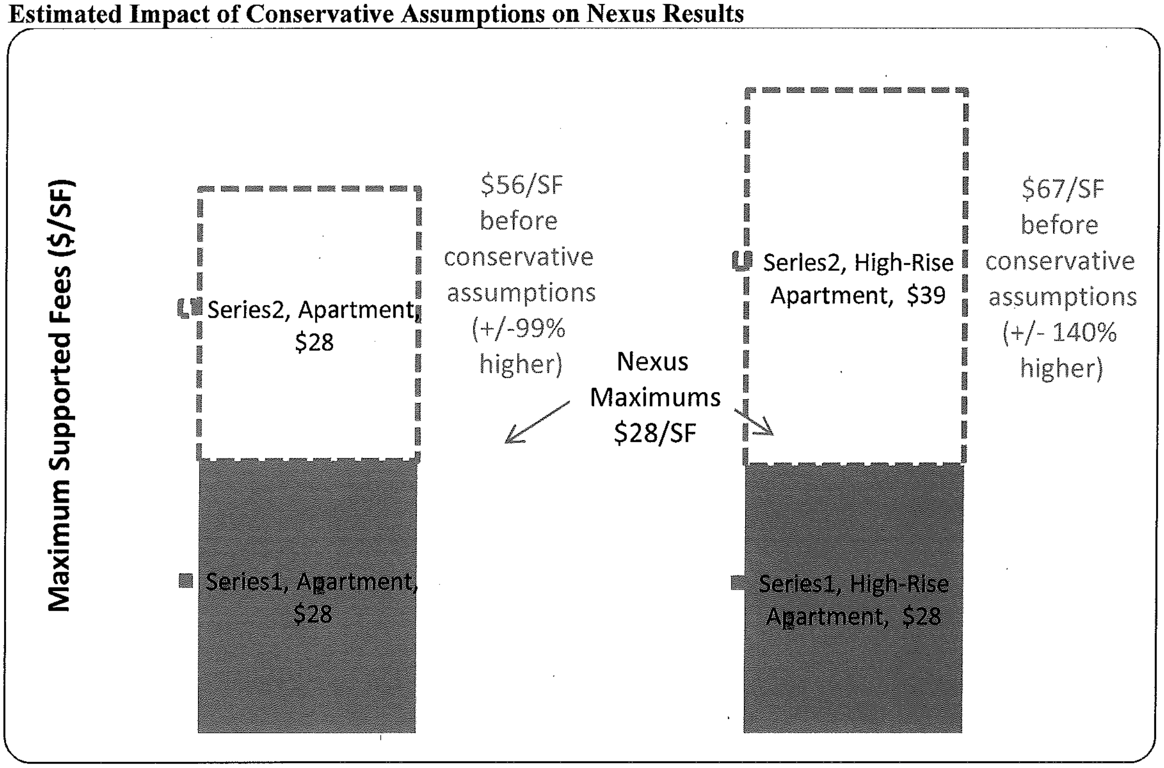
Note: all figures shown in the chart apply to the stacked flat apartment prototype .

The nexus analysis reflected a number of conservative assumptions, including:

- KMA uses conservative rent levels which, in turn, translate to conservative household income and lower estimated demand for new service jobs. Apartment rents are from summer 2013 and were not updated for the 9%-10% increase in rents since that time. High-rise rents are estimated to be 80% or less of the market.
- 20% of new service jobs are assumed to be filled by local residents who already have housing.
- The supportable impact fee is directly tied to the financial gap associated with providing affordable housing units. The KMA analysis assumes that Low Income Housing Tax Credit financing will be available to fill a portion of the financial gaps, which in turn reduces the supportable impact fee amount.
- When calculating the number of new units needed to house new service workers, the analysis assumes that existing conditions of high numbers of people per unit, particularly at lower income levels, will continue. The number of units needed to house new workers would increase approximately 4% if an adjustment were made to achieve the standard in the City's Housing Element (one person per room).

It is estimated that the maximum supported fee level would have exceeded $56 if these conservative assumptions had not been used, as follows:

Estimated Impact of Conservative Assumptions on Nexus Results



The connection between consumer spending and jobs is supported by Bureau of Labor Statistics (U.S. Department of Labor), in its October 2014 "Monthly Labor Review," notes for the past decade, consumer spending has been considered an "engine" of economic growth in the United States. In 2012, consumers were responsible for almost 71% of the U.S. gross domestic product, up almost 8% since 1960. At the local level, the connection between new rental development and jobs has been supported by the National Association of Home Builders (NAHB), in a June 2009 report ("The Local Impact of Home Building in a Typical Metro Area"), concludes that the construction of rental apartments leads to permanent jobs that result from the new apartments being occupied and participating in the local economy year after year, with 32 new jobs created by every 100 new apartments. This is consistent with the conclusion of the Nexus Analysis that between 35 and 40 jobs would be created for every 100 new apartments.

Historic Relationship between Growth in Housing and Service Jobs

As a result of comments that staff received during the outreach period, KMA was asked to provide information on the historic relationship between housing and service jobs in Santa Clara County (see Part F of Attachment 3). The historic analysis was performed at the County level due to data availability and because patterns can be more complex for smaller geographic areas such as a city, given that spending crosses jurisdictional lines. The following conclusions can be reached from this historic analysis:

- Service Jobs Increased with Growth in Housing - Jobs in retail, restaurants, healthcare, and education grew as the number of housing units increased.
- Consistent Relationship – The ratio between service jobs and housing units has held at 41 to 52 jobs per residential unit over the historic period which is consistent with the nexus employment estimates.
- Pattern Supports Nexus – The historic pattern lends support to the key concept behind the nexus that growth in residential units is linked to growth in service jobs like retail and restaurants.

Recommended Program Provisions

Housing Department staff has worked diligently over the past year to meet with stakeholders and the public to gather input on the provisions to be included in the Program. During the outreach processes in both 2013 and 2014, the public, housing advocates, and developer stakeholders expressed a number of alternative ways to structure the Program which are enumerated in Part 4 of the Attachment. Feedback from outreach efforts led the Housing Department to frame its recommendations for the Housing Impact Fee Program using the following principles:

- Simplicity – The Program should be easy for the developers to understand.
- Efficiency – The Program should be efficient for the City to administer and should cover staff costs to the extent possible.
- Certainty – The Program should provide advance notice of what is required and how it will apply with clear rules and procedures.

To achieve these objectives, the Program should be designed to include procedures and requirements that are as closely aligned as possible with similar City programs.

In considering the proposed fee levels, staff was mindful of the Envision San Jose 2040 General Plan's identification of high-rise residential development in Downtown as playing a major role in the long range revitalization of the downtown area as the cultural and recreational hub for the City arts, entertainment and sporting activities. Downtown contributes towards the positive identity of the City to the region, the nation and abroad, and is the only location in the South Bay that actively promotes high-rise development.

The recommendation below for a $17 per square foot fee was also informed by the conclusion reached in the Financial Feasibility analysis on how a fee could be absorbed by the market. Assuming that the Housing Impact Fee was imposed immediately (i.e., without any grandfathering provision for pipeline projects), it could be absorbed by a portion of increased rents that occur for market reasons, by decreased development costs, or by decreased land values. The approximate size of those impacts would vary by the fee level imposed have been estimated by KMA in the Supplement report as follows:

	$13 per sq. ft.	$17 per sq. ft.	$20 per sq. ft.
Apartment Rent INCREASE (+/-)	+0.5%	+1.5%	+2.0%
OR			
Total Development Cost DECREASE (+/-)	-1.0%	-2.0%	-3.0%
OR			
Land Value DECREASE (+/-)	-15%	-20%	-25%

Increased rents since the analysis was conducted approximately a year ago already exceed the relatively modest increases shown for illustration, which is demonstration that such market changes can and do occur all the time. Moreover, in weighing all of the factors described in this memorandum, the City's interests are best served by the adoption of Housing Impact Fee even if there is some impact on market rate rents.

While rents have increased over the past year, without an update to the feasibility analysis, conclusions cannot be drawn about how the economics of apartment developments have evolved nor predict how they may continue to evolve prior to proposed fees coming into effect following either the grandfathering or phase-in periods that are proposed.

The Housing Department is recommending the following components for the Housing Impact Fee Program.

- <u>Fee Level</u> -- $17.00 per net, rentable square foot in market-rate, rental housing developments of three or more units. This is what is currently being charged to for-sale developers under the in-lieu fee option of the Redevelopment Area Inclusionary Housing

Policy (and was charged to rental housing developers under the in-lieu fee option until this requirement was suspended by the City Council in response to the *Palmer* decision). As the former inclusionary in-lieu fee obligation was feasible from a development perspective – evidenced by the production of new apartments in San Jose during the years the policy was in effect – the comparable new fee should remain feasible. Staff is recommending a square-footage-based fee since smaller units imply smaller household sizes with correspondingly smaller spending impacts in the community (and larger units would have larger spending impacts). This would place San Jose's Housing Impact Fee within the range of other Bay Area cities (see Part B of Attachment 3).

- Applicability by Tenure and Construction Type – Charge the full $17 per square foot fee on all rental building types except for high-rise developments in the Downtown area. The Financial Feasibility analysis prepared by KMA (see Attachment 2) shows that a housing impact fee would be a financial challenge for high-rise residential developments. Accordingly, staff is recommending that the first 1,000 units in Downtown high-rise developments beyond the 2,564 units already built, under construction or anticipated to be under construction by 2015 be subject to a Housing Impact Fee level at 50% of the Citywide rate (or $8.50 per square foot) if not already subject to the grandfathering exemption. For this purpose, a high-rise residential development is defined as a building 150 feet or more in height above street level.

- Fee Adjustment – After the first year following the operative date of the Resolution, increase fee levels 2.4% to address the increases in construction costs for affordable housing that the Fee is intended to finance. This level of annual fee increase is less than the 3% increase over the past year in the Building Cost Index published by the Engineering News-Record. The nexus study will be updated at least every five years. Based on the staff recommendation of $17 per square foot the fee would increase as follows:

Date	Full Fee Level	Reduced Fee Level for Downtown High-Rises
July 1, 2016	$17.00	$8.50
July 1, 2017	$17.41	$8.70
July 1, 2018	$17.83	$8.91

- Timing of Fee Collection – Collect the Housing Impact Fee prior to the issuance of building permits, while providing the developer the opportunity to appeal this requirement if it can be shown that the Impact Fees are not intended to reimburse the City for expenditures previously made and that the City has not: (a) established a Housing Impact Fee fund or account; (b) collected any Fee revenue; (c) authorized the expenditure of Fee revenue; and (d) adopted a plan or schedule for affordable housing project funding. Should a developer's appeal be successful, the Fee would be collected prior to a Temporary Certificate of Occupancy or Certificate of Occupancy for that development project, whichever comes first; a recorded Fee Agreement between the developer and the City to this effect would be a required prerequisite to building permit issuance and the amount of the Fee to be collected would be established at the time that the Fee Agreement is executed (similar to the way the Parkland Impact Fee is collected in this circumstance).

- Operative Date and Grandfathering/Exemptions – Staff recommends that the operative date of the resolution or ordinance be July 1, 2016, preceded by the implementation of an exemption process, as outlined below, in order to minimize negative financial impacts on development projects in the pipeline. The proposed grandfathering process is the most generous timeline proposed by any new City fee or fee increase in the recent past. A development project can be exempted from the provisions of the Program if it meets both of the following conditions:

  1. Prior to the Operative date of the Resolution, a proposed rental housing development has received City approval for one of the following entitlements and the entitlement has not expired:
     - PD Permit
     - Site Development Permit
     - Conditional Use Permit
     - Special Use Permit

  2. Prior to January 31, 2020, a rental housing development receives a Certificate of Occupancy.

  In order to be exempted, the Developer will need to submit a pipeline application with evidence of the required permit to the Housing Department by June 30, 2016, accompanied by a fee. The fee will cover the cost for staff to track compliance and monitoring. The amount of the fee will be established in the adoption of the Annual Fees and Charges Resolution that will occur during the 2015-2016 budget process.

  Staff also recommends that the City Manager be granted the authority to extend the timelines outlined above when a change in federal, state or local law causes the need for material redesign of the project.

The following recommended provision is also reflected in the fee legislation:

- Offsets to the Fee – Developers who have entered a 55-year affordability restriction, for a portion of a mixed-income development, enforceable by a government entity (e.g.,TCAC), will not be assessed a fee for affordable apartments provided.

Additional alternatives to paying the fee are not a part of the current legislation. If there is sufficient demand, an alternative for land dedication or other measures can be added in the future.

Housing Impact Fee Revenue/Cost Implications

Revenue from the proposed Housing Impact Fee will be accounted for separately. Revenue, interest earned, and expenditures from this fund will be reported annually pursuant to the requirements of the Mitigation Fee Act.

The Housing Impact Fee Expenditure Plan (see Part C of Attachment 3) details the uses to which the Fee revenue will be used. The Plan targets funds to the different income levels based on the demand for each level identified in the Nexus Analysis. Because of the recommended exemption for pipeline projects, staff does not anticipate any significant Impact Fee revenue before Fiscal Year 2019-20. The Plan explains that City financing housing for extremely low-, very low-, and low-income households is in the form of loans to rental housing developers, while assistance for moderate-income households is in the form of down-payment assistance loans for home purchases.

The Expenditure Plan is based on projections of future growth contained in the City's RHNA numbers. It should be noted that San Jose has historically produced more market-rate housing units than contained in the RHNA projections. Building permit data from the past four fiscal years suggests that production of market-rate rental housing could be as high as 2,000 units per year rather than the 1,439 units cited in the Expenditure Plan. At 2,000 units per year, annual revenues would be over $30 million instead of the $22 million figure in the Plan.

EVALUATION AND FOLLOW-UP

The Mitigation Fee Act requires that the City provide an annual report on actual Housing Impact Fee revenues, future revenue projections, and expenditures of those revenues. The Housing Department will provide such a report each December for the prior fiscal year.

POLICY ALTERNATIVES

Alternative #1: Do not approve a Housing Impact Fee Program

Pros: Market-rate rental housing developments would not be charged an additional mitigation impact fee by the City.

Cons: Failure to provide affordable housing locally for new workers in lower- and moderate-income retail and service jobs could have a substantial, negative effect on the environment and the local economy, as follows:

- Those lower- and moderate-income workers would be forced to find housing affordable to them in distant communities, far from employment centers and inadequately served by public transit, thereby leading to increased vehicular traffic at commute times that will result in increased noise and air pollution.

- Businesses in San Jose will find it more difficult to attract and retain the variety of workers they need to prosper and grow.
- Neighborhoods would suffer the impact of overcrowding, including increased traffic and parking as lower-income households will need to overcrowd to afford existing housing costs.

Reason for not recommending: The negative environmental and economic impacts of not providing sufficient affordable housing locally more than offset the marginal, if any, impact of the Housing Impact Fee Program on market-rate rents.

Alternatives to the detailed policy recommendations set forth in this memorandum are included in Part A of Attachment 3.

PUBLIC OUTREACH/INTEREST

E-mail notification of the City Council meeting will be sent to a list of nearly 600 persons and organizations who have expressed interest in the Housing Impact Fee. Additionally, over 140 individuals who are subscribers to the Housing Impact Fee page on the Housing Department's website will receive "news and announcement" bulletins electronically. This report will be posted on the City Council agenda website for the November 18, 2014 meeting.

Prior to starting work on the Nexus Analysis in 2013, staff and the consultant conducted two developer stakeholder meetings to obtain developer input and participation regarding the nexus study and the feasibility analysis.

Other public outreach efforts have included the following:

Nexus Study (2014) – 90 day review period	Four public forums throughout the City to share the results of the nexus and to review the potential policy options including one developer stakeholder meeting.
Housing Impact Fee (2014) – Policy Recommendations	Five open public forums throughout the City to review the draft staff recommendation including one developer stakeholder session and 6 individual developer meetings.

Part D of Attachment 3 provides more detail on the results of the public outreach process.

COORDINATION

Preparation of this report was coordinated with the Office of Economic Development, the Department of Planning, Building and Code Enforcement, the Office of the City Attorney, and the City Manager's Budget Office.

POLICY ALIGNMENT

The Housing Impact Fee Program implements several City policy objectives that are articulated in the Envision San Jose 2040 General Plan, as follows:

General Plan Policies

H-1.2 Facilitate the provision of housing sites and structures across location, type, price and status as rental or ownership that respond to the needs all economic and demographic segments of the community including seniors, families, the homeless and individuals with special needs.

H-1.6 Foster the production of housing to serve the "starter" housing market by leveraging financial resources such as purchasing assistance programs and by encouraging market-rate building typologies that serve the "starter" housing market.

H-1.9 Facilitate the development of housing to meet San Jose's fair share of the County's and region's housing needs.

H-2.1 Facilitate the production of extremely low-, very low-, low- and moderate-income housing by maximum use of appropriate policies and financial resources at the federal, state and local levels, and various other programs.

H-2.8 Coordinate and implement housing policies and goals contained in the City's Consolidated Plan, and its 5-Year Investment Plan.

H-2.11 Seek permanent sources of affordable housing funds.

H-3.3 Situate housing in an environment that promotes the health, safety, and well-being of the occupants and is close to services and amenities.

H-4.2 Minimize housing's contribution to greenhouse gas emissions, and locate housing, consistent with our City's land use and transportation goals and policies, to reduce vehicle miles traveled and auto dependency.

Additionally, the Council will, on November 18, 2014, be considering the following General Plan Text Amendments prior to the consideration of the Housing Impact Fee Program (shown in a ~~deletions~~/additions format):

- New Policy H-1.10 Facilitate housing that is affordable to those employed in population-serving, business-support, and driving industries.
- Goal H-2 Affordable Housing: ~~Increase, preserve and improve San Jose's affordable housing stock~~. Preserve and improved San Jose's existing affordable housing stock and increase its supply such that 15% of all new housing stock developed is affordable to low-, very low-, and extremely low-income households.
- New Policy H-2.8: Facilitate the production of affordable and safe housing for workers who provide goods and services to San Jose residents and businesses.

CEQA

Not a Project, File No. PP10-067 – Section 15378(b)(4) of the Guidelines for Implementation of the California Environmental Quality Act excludes the following from the definition of projects subject to environmental review requirements: "The creation of a government funding mechanism or other government fiscal activities which do not involve any commitment to a specific project which may result in a potentially significant physical impact on the environment."

/s/
LESLYE CORSGLIA
Director, Housing Department

Attachment 1: Residential Nexus Analysis, San Jose, California (October 2014)
Attachment 2: Supplement to the Residential Nexus Analysis (October 2014)
Attachment 3: Supplemental Materials
Part A: Detailed Policy Alternatives Considered
Part B: List of Bay Area Jurisdictions with Adopted Housing Impact Fees
Part C: Housing Impact Fee Expenditure Plan
Part D: Summary of Public Comments
Part E: Correspondence
Part F: Historic Relationship Between Growth in Housing and Service Jobs in Resident-Serving Sectors

For questions please contact Jacky Morales-Ferrand, Assistant Director of Housing, at 408-535-3855