CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: April 3, 2018

Approved D:DSyL Date 4/11/18

SUBJECT: AMENDMENTS TO PROCEDURES FOR REMOVAL OF RENT STABILIZED UNITS FROM THE RENTAL MARKET (ELLIS ACT ORDINANCE)

RECOMMENDATION

(a) Accept the staff report.

(b) Approve an ordinance amending Part 11 of Chapter 17.23 of Title 17 of the San José Municipal Code to:

- (1) Modify the re-control provisions to subject the greater of either the number of apartments removed from the market, *or* 50% of new apartments built to the Apartment Rent Ordinance (ARO).
- (2) Modify the re-control provisions to subject additional apartments beyond the base units are limited to the current annual general increase of 5%.
- (3) Allow an exemption from the re-control provisions if at least twenty (20) newly constructed rental units are being created. The re-control requirement under this Section will be waived if the property owner:
  - (i) Develops fifteen percent (15%) of the newly constructed units as on-site affordable rental units consistent with the standards and affordability restriction requirements in the Inclusionary Housing Ordinance, Chapter 5.08 of Title 5 of the San José Municipal Code and its implementing guidelines; and
  - (ii) Develops an additional five percent (5%) of the newly constructed units as on-site affordable rental units restricted at 100% of area median income, but otherwise consistent with the standards in the Inclusionary Housing Ordinance and implementing guidelines.
- (4) Include apartments buildings with three units under the Ellis Act.
- (5) Allow non-ARO apartments with three units or more built after 1979 to provide 120-day notification to their tenants and the City and to provide relocation consultant services to impacted tenants.

OUTCOME

City Council approval of the recommended actions will amend San José's Ellis Act Ordinance to require the greater of the number of demolished units or half of newly constructed replacement apartments (rather than all of the newly constructed units, as currently required) to be re-controlled by the Apartment Rent Ordinance. In addition, apartments with three units will be subject to Ellis Act. Owners of apartments with three or more units built after 1979 will be required to provide notification and relocation consulting assistance to tenants, when those properties are withdrawn from the rental market.

EXECUTIVE SUMMARY

The City Council approved the Ellis Act Ordinance on April 18, 2018. This action established a process by which a property owner can remove their apartments from the rental market. Upon approval of the Ellis Act Ordinance, the City Council provided direction to the City Manager to return with additional research regarding the impact of subjecting all "replacement" apartments to re-control by the Apartment Rent Ordinance. Replacement apartments are new apartments constructed on the site of apartments removed from the market via the Ellis Act Ordinance.

The Housing Department reviewed several options pertaining to the number of new apartments that will be subject to the Ellis Act. As currently adopted, 100% of all new apartments constructed as replacement apartments are subject "re-control" and therefore must comply with the Apartment Rent Ordinance (ARO). After evaluating different alternatives, the Housing Department recommends that the re-control provision of the Ellis Act be modified to subject the greater of either the number of apartments removed from the market *or* 50% of new apartments built, to the ARO. The Housing Department further recommends that exemption from the re-control provisions be allowed if 20% of the new apartments are deed-restricted affordable apartments, and are included in the new development (i.e. built on-site). It is the Department's conclusion that this approach helps preserve rent stabilized apartments and provides developers with viable options to meet the Ellis Act requirements and provide new housing opportunities.

Staff is also proposing two additional changes to the Ellis Act Ordinance. When implementing the Ellis Act Ordinance and Tenant Protection Ordinance (TPO), staff identified inconsistencies between the apartments covered by these ordinances. These inconsistencies have created technical challenges for landlords seeking to withdraw triplexes built before 1979 and apartment buildings with three apartments or more built after 1979.

Due to the discrepancy between the units covered by the TPO (three units or more) and the Ellis Act Ordinance (four units or more), developers removing triplexes from the market are not able to site an Ellis Act reason to provide tenants with the required notice to vacate. The Housing Department recommends an amendment to the Ellis Act Ordinance so that it applies to apartment complexes with three units or more. An additional 1,056 triplex apartment units would be covered by the local Ellis Act Ordinance if this recommendation is approved. This would align the TPO and Ellis Act Ordinance and provide a practical means for owners to address the displacement of tenants.

Generally, apartments constructed and occupied after September 7, 1979 are not subject to the ARO, but are subject to the TPO. To address the issue where owners want to remove non-ARO apartments from the market, the Housing Department recommends that owners of such apartments be required to provide a 120-day notification and offer relocation consultation to tenants. If adopted, this would provide owners with a practical alternative to remove tenants for properties they wish to redevelop for other uses. Without this option, owners would have to negotiate individual voluntary agreements with tenants or find some other means to legally evict tenants.

BACKGROUND

On May 10, 2016, the City Council directed staff to develop a local Ellis Act Ordinance to address the removal of rent stabilized properties from the rental market that applied to buildings with four or more apartments. The Council gave this direction as part of the policies adopted to strengthen the ARO.

On April 18, 2017, City Council the City Council approved an Ellis Act Ordinance that provides procedures on the control of rents for apartments constructed or returned to the rental market within five years of withdrawal. As a part of this action, City Council provided:

1. Direction to the City Manager to complete additional research regarding the impact of subjecting all replacement units to re-control by the Ellis Act; and
2. Direction to provide the City Council with additional research regarding existing Ellis Act Ordinances throughout California.

Apartment Rent Ordinance

The ARO promotes stability and fairness within the residential rental market in the City, thereby serving the public peace, health, safety, and public welfare. To protect tenants from excessive and unreasonable rent increases, the ARO limits annual rent increases to 5% per year. It requires notices be provided to the City and regulates how much and what types of costs may be passed through to tenants. In San José, all apartments of three or more units built and occupied prior to September 7, 1979, are subject to the ARO.

Ellis Act Ordinance

The Ellis Act Ordinance establishes a process by which a property owner can remove their apartments from the rental market. It should be noted that Ellis Act provisions only apply to apartments that are subject to the City's ARO. Adoption of an Ellis Act Ordinance was included as part of the top City Council priority. The City Council adopted the Ellis Act on April 18, 2017. As part of that action, the City Council directed that the Administration 1) Complete additional research regarding the impact of subjecting all replacement units to re-control by the Ellis Act; and (2) Provide the City Council with additional research regarding existing Ellis Act Ordinances throughout California.

The City's Ellis Act Ordinance also provides benefits to tenants of rent ARO apartments that will be withdrawn from the market. A summary of the Ellis Act Ordinance requirements is provided below:

- **Noticing** – All households must be provided with a minimum of 120 days' notice prior to the removal of the property from the rental market. Special populations including residents over the age of 62, disabled, terminally/catastrophically ill, and residents with school-aged children must be given up to one-year notice.
- **Relocation Benefits** – All tenants are eligible to receive relocation benefits. Special populations including low-income residents, residents over the age of 62, disabled, terminally/catastrophically ill, and residents with school-aged children are eligible for additional relocation benefits.
- **Right to Return** – If the apartments return to the rental market within ten years, tenants have a right to return to their apartments.
- **Re-control** – If a property owner demolishes existing rent stabilized apartments, all new apartments built at the same location within five years will be subject to the City's Apartment Rent Ordinance.

Property owners that remove rent stabilized apartments from the market are subject to these re-control provisions. In addition, all new housing with 20 units or more are subject to the City's Inclusionary Housing Ordinance.

Inclusionary Housing Ordinance

The Inclusionary Housing Ordinance (IHO), Chapter 5.08 of the San José Municipal Code, was adopted on January 12, 2010. The IHO requires all residential developers who create new, additional, or modified for-sale or rental units, to provide 15% of housing on-site and affordable to income qualified buyers/renters. Developers also have other options to meet the inclusionary requirement. These options include building affordable apartments offsite or paying an in-lieu fee. If the residential project is a rental development and the owner chooses to meet this obligation by providing the affordable apartments on-site, 9% of the apartments must be restricted at 80% Area Median Income (AMI) and 6% of the apartments must be restricted at 50% AMI.

On November 18, 2014, the City of San José adopted an Affordable Housing Impact Fee (AHIF) that applies to rental developments. The fee was intended to fund new development to help meet the increased affordable housing demand created by new market rate rental housing. On December 19, 2017, the City Council approved a transition from the AHIF to the IHO for projects with 20 units or more. As a result, new market-rate rental developments have a time-limited option to remain under the AHIF program if certain criteria are met. More information on the Inclusionary Housing Ordinance Program can be found on the following webpage: www.sjhousing.org/IHO.

This memorandum complies with the City Council's direction to address the re-control issue and provides property owners with options to meet their Ellis Act obligations.

ANALYSIS

In order to develop recommendations for proposed changes to the Ellis Act Ordinance, the Housing Department completed extensive research and out outreach. These efforts include holding individual stakeholder meetings, convening public meetings, engaging a consultant to complete a study on potential impacts to development, and completing research on Ellis Act provisions from other jurisdictions. The results of these efforts are contained in the Department's analysis, which is organized into the following three topic areas.

1) **Re-Control of Apartments** – Addresses the re-control issue as currently delineated in the Ellis Act Ordinance and provide options.
2) **Apartments with Three Units** – Addresses Ellis Act issues associated with three-unit apartments.
3) **Apartments Built After 1979** – Addresses noticing requirements for apartments being removed from the market that were built after September 7, 1979.

1. Re-Control of Apartments

As the demand for housing in San José increases, pressure to redevelop rent stabilized apartments continues to rise. There are approximately 40,000 apartments subject to the Apartment Rent Ordinance (ARO) and the City's Ellis Act Ordinance. Many of these apartments are located in areas that are likely to be redeveloped in the next 20 years. The City's General Plan designates areas of growth by urban village areas. These areas allow for higher densities where redevelopment of existing rent stabilized apartments may occur.

Based on research from the Planning Department, almost 12,000 (30%) of current apartments covered by the Apartment Rent Ordinance are located in urban villages. Staff has experienced an increase in inquiries regarding redevelopment in these areas. This is likely to increase as the urban village plans are adopted. Therefore, re-control of some or all the units constructed after ARO units are demolished, is necessary to preserve the limited supply of rent stabilized housing.

Since the adoption of the Ellis Act, staff has received inquiries from developers who are interested in demolishing existing ARO apartments to build new housing. The potential projects are in various stages of the planning process. A list of these inquiries is provided as **Attachment A**.

Existing Re-Control Provisions

The Ellis Act provides requirements for apartments being either rehabilitated or demolished and returned to the market within five years after being withdrawn through the Ellis Act. The adopted Ordinance requires that all new apartments be subject to the City's ARO (re-control). For example, if 10 apartments were removed and 20 apartments were constructed on the same property, all 20 new apartments would be subject to the ARO.

The Housing Department's analysis of the re-control issue included three components: 1) input from meetings with developers; 2) a report prepared by David Paul Rosen and Associates and; 3) research on re-control provisions in other cities. Based on this analysis, staff drew the following conclusions:

- Developers need certainty in rents to finance new development,
- 5% rent increase limit has no empirical impact on financing new apartments,
- Tenants favor affordable housing over rent controlled apartments,
- Other cities require re-control for all new apartments, and
- Unintended consequence of re-control is the loss of rent stabilized apartments.

The information and analysis that lead to these conclusions is provided below.

Developers Desire Certainty in Rents in Order to Finance New Development

Staff met with developers to discuss the re-control options for the Ellis Act Ordinance. During these meetings, participants spoke of communities in the region that are introducing inclusionary and rent stabilization requirements. Developers stated that deed-restricted affordable housing is predictable and understood by lenders and developers. This is because the deed-restriction ties rents to a predictable scale for an extended period of time. Rent stabilization, however, is perceived as unpredictable because a local governing body could make a decision to tighten the rent stabilization requirements at any time. According to developers, this lack of certainty increases risk for the development of new housing subject to rent stabilized requirements. Developers were generally interested in exploring an option to provide affordable housing apartments in lieu of rent control provisions. This option allows developers to meet the City's Inclusionary Housing Ordinance requirements and Ellis Act Ordinance requirements at the same time. It would also provide the certainty necessary to finance new projects.

Staff presented the proposed changes to the Developers Roundtable. Participants indicated the preferred alternative would be to have the number of apartments subject to re-control by the Ellis Act equal the number of apartments demolished. In other words, replacement we be on a one-for-one basis. The group also discussed their perspective that the re-control provisions in the Ellis Act may encourage developers to avoid the redevelopment of rent controlled apartments when considering viable sites for new projects.

The 5% Rent Increase Limit Has No Empirical Impact on Financing New Apartments

The City engaged David Paul Rosen and Associates to evaluate the potential impact of ARO obligations, resulting from the demolition of ARO properties, on the development of new market rate housing. The consultant evaluated the difference in cash flows, property valuation, and supportable debt under alternative restrictions to determine the extent to which the financing of the new apartments is affected. The results of this work can be found in the report entitled, *Assessing the Potential Effect of the ARO on New Development*. The report is included as **Attachment B.** The report concludes that first lenders typically underwrite new development assuming 2% - 3% growth rates in rents. The 5% annual general increase in the ARO would not be a limitation to this financing.

When interviewing funders, the study found some second tier debt providers indicated that the 5% limitation would "chill" their interest in these projects due to the limitation on the ability to impose sharp increases in rents in tight rental markets. The Rosen study indicates that there is no 10-year period since 1970 where markets have increased by more than an average of 5% per year, minimizing the statistical significance of this concern. However, there may be a perceived risk to developing under rent control provisions in the second tier lending market.

Tenants Favor Affordable Housing Over Rent Controlled Apartments

Staff hosted public meetings and met with tenant advocates to discuss the proposed revisions to the Ellis Act Ordinance. Generally, the tenant stakeholders did not support changes to the current re-control provisions which require all new apartments be subject to the Apartment Rent Ordinance. When discussing a re-control option to substitute rent control provisions for on-site affordable housing, tenant stakeholders expressed an interest in the affordable housing option. Under the Ellis Act, rents are reset to market rates following demolition of apartments, then limiting annual increases to 5% annually. When these provisions were explained to tenants, they stated rents set by affordability restrictions may be more attainable for residents displaced by Ellis Act withdraws than rents for apartments under rent control. Tenant stakeholders also expressed an interest in a higher percentage requirement for affordable housing apartments at the lowest levels possible.

Other Cities Require Re-control for All New Apartments

The Housing Department researched the different re-control provisions in cities with Ellis Act ordinances. The ordinances of San Francisco, Berkeley, West Hollywood, Los Angeles, and Santa Monica have provisions requiring that all new housing developments, following an Ellis Act withdrawal, are subject to the rent control provisions of that jurisdiction. This is consistent with the San José's current requirements. Los Angeles provides an exemption from rent control provisions to developers who replace the new units with 20% restricted affordable units. Table 1 summarizes these provisions.

Table 1: Summary of Cities with Ellis Act Provisions

	San Francisco	Berkeley	West Hollywood	Santa Monica	Los Angeles
What is covered by Ellis?	3 units or more	All	2 units or more & single family homes when tenant occupied	All	5 units or more
How many replacement units will be subject to re-control?	All	All	All	All	All
Are there exemptions to re-control?	N/A	N/A	N/A	N/A	Yes

<u>An Unintended Consequence of Re-control is the Loss of Rent Stabilized Apartments</u>

The Housing Department also looked at the impact of Ellis Act Ordinance provisions in these jurisdictions. The Department found that in some jurisdictions which require all new apartments to be covered by rent control provisions, the overall number of rent stabilized apartments erodes over time. Even if the jurisdiction requires re-control of all new units, the provisions may lead developers to make choices that avoid the local rent ordinance obligations. Santa Monica is a case in point. It has the longest standing Ellis Act in the State. According to the 2016 Santa Monica Rent Control Board Consolidated Annual Report, Santa Monica has lost over 2,000 rent controlled apartments through Ellis Act removals. A summary of the apartments withdrawn from the rental market versus those added under the re-control provisions is provided in Table 2.

Table 2: Santa Monica Apartments and Properties Withdrawn 1986-2016

	Apartments	Properties
Withdrawn	2,975	609
Returned to the Market	852	163
Net loss of Covered Apartments due to withdraw	**2,123**	**446**

Source: 2016 Santa Monica Rent Control Board Consolidated Annual Report, p. 32

Santa Monica requires that all newly constructed apartments built within five years are required to be covered by rent control. However, staff from that City have observed that properties do not always return to the market. One reason for this is because apartments are often replaced with for-sale housing, commercial use, and/or mixed use development. In addition, developers building rental housing sometimes do not bring the apartments into the rental market until the five-year re-control period required under the Ellis Act has lapsed. These factors have led to the net loss of apartments covered by Santa Monica's rent control provisions.

Re-Control Options

Based on the conclusions previously sited, the Housing Department examined the following options in Table 3 regarding the number of new apartments that should be re-controlled under the Ellis Act.

Table 3: Alternatives for Re-Control Provisions

Alternatives	Example	Considerations
All Units – All new apartments are re-controlled.	20 apartments removed 60 apartments built ***All 60 apartments covered***	• Consistent with all other California jurisdictions
50% of New Development – The greater of the number of apartments destroyed or 50% of the new apartments constructed.	20 apartments removed 60 apartments built ***30 apartments covered***	• Potential gain of apartments covered by the ARO
One-for-One – The number of apartments destroyed is re-controlled on a one-for-one basis.	20 apartments removed 60 apartments built ***20 apartments covered***	• No net loss of apartments covered by the ARO
20% Restricted Affordable – If inclusionary obligations are met by building 20% restricted affordable apartments on-site, the project may be exempted from re-control requirements.	20 apartments removed 60 apartments built 12 apartments affordable ***0 apartments covered***	• Incentive to build affordable housing on-site • Provides lower rents for 20% of the apartments

After reviewing these options, staff developed the following recommendations.

<u>Staff Recommends that 50% of New Apartments be Re-controlled</u>

The study by David Paul Rosen and Associates concludes that the 5% annual general increase allowed by the Apartment Rent Ordinance does not significantly impact the potential financing for a new housing development. Conversations with developers and second tier lenders indicated a perceived risk associated with development with these provisions due to limitations on rent increases and the uncertainty of rent control provisions in the future. In order to address the concerns about certainty in future years, staff recommends that all net new apartments built under the current Ellis Act be limited to an annual general increase of 5%, independent of any future change to the annual general increase in the Apartment Rent Ordinance.

Staff also considered the unintended consequences learned from other cities that require all new development to be subject to re-control provisions. In order to address the potential impact of developers avoiding the development of rental housing, staff recommends limiting the re-control provisions to half of the newly developed apartments. As a further clarification, the Housing Department recommends that the re-control provision of the Ellis Act be modified to subject the greater of either the number of apartments removed from the market, *or* 50% of new apartments built, to the Apartment Rent Ordinance. This approach is intended to preserve rent stabilized apartments over time. Additionally, staff is recommending that all rent stabilized apartments be limited to a 5% annual rent increase, addressing developer concerns regarding certainty of future rent increases.

<u>Staff Recommends a Waiver from Re-control Provisions for 20% On-site Affordable Housing</u>

The Housing Department further recommends that an exemption from the re-control provisions be allowed if a developer provides 15% of the newly constructed apartments as on-site affordable rental apartments consistent with the standards and affordability restriction requirements in the Inclusionary Housing Ordinance (i.e. 9% of the apartments restricted at 80% AMI, and 6% at 50% AMI). The staff recommendation also includes a requirement that developers provide an additional 5% of the newly constructed apartments as on-site affordable rental apartments restricted at 100% of area median income. The Department's conclusion is that this approach provides developers with viable options to meet the Ellis Act requirements and provides new affordable housing opportunities for the community.

2) <u>ARO Apartments with Three Units</u>

After the Ellis Act Ordinance came into effect on May 26, 2017, staff immediately received calls from developers interested in redeveloping triplex apartment buildings covered by the ARO. Aside from being covered by the ARO, triplexes are also covered by the Tenant Protection Ordinance (TPO). The TPO eliminates no-cause evictions and gives specific reasons under which landlords can evict tenants. However, due to the discrepancy between the units covered by the TPO (three units or more) and the Ellis Act Ordinance (four units or more), developers removing triplexes from the market are not able to site an Ellis Act reason to provide tenants with the required notice to vacate. In addition, tenants cannot receive relocation assistance benefits required under the Ellis Act Ordinance.

There are 345 triplexes subject to the ARO with a total of 1,035 apartments. A change to the Ellis Act to include buildings with three apartments or more would increase the number of apartments covered by 1,035 apartments.

Staff Recommends Including Apartments with Three Units Under the Ellis Act

The Housing Department recommends an amendment to the Ellis Act Ordinance so that it applies to apartment complexes with three units or more. This would align the ARO, TPO, and Ellis Act Ordinance with regards to triplexes. An additional 1,056 apartments will be covered by the local Ellis Act Ordinance. This modification will provide consistency between the TPO and the Ellis Act for owners, tenants, and staff charged with implementing the ordinance.

3) Apartments Built After 1979

After the Ellis Act Ordinance came into effect on May 26, 2017, staff received an inquiry from a developer who wanted to remove an eight-unit apartment building built in 2005 from the rental market. The purpose of removal was to assemble land for new development. All apartments are subject to the TPO, which limits the causes for eviction. However, apartments built after September 7, 1979 are not subject to the ARO or the Ellis Act Ordinance, so the owner could not use the Ellis Act as a method to remove the tenants. In this case, the property owner did not have a straightforward method to remove all of the tenants living in the eight-unit apartment building based because the Ellis Act Ordinance does not apply to this property.

Staff Recommends Including Apartments Built After 1979 to be Included Under Ellis Act

In order to address this issue, the Housing Department recommends that owners who wish to utilize the Ellis Act Ordinance be required to provide a 120-day notification to tenants of apartments being removed from the market that were built after September 7, 1979. The Housing Department also recommends that the owner be required to offer relocation consultant services to impacted tenants. Since these are market rate apartments, staff is not recommending that owners be required to make relocation payments to tenants of these units.

If adopted, this would provide owners of apartments constructed after 1979 with a practical alternative to removing tenants from properties they wish to remove from the rental market. Without this option, owners would have to negotiate individual voluntary agreements with tenants or find some other means to legally evict them. The requirements for these apartments would be limited to the 120-day noticing requirements and providing access to a relocation specialist.

PUBLIC OUTREACH

As indicated throughout this document, the Housing Department met with a wide range of stakeholders while developing the proposed Ellis Act Ordinance. Staff met with developers, property owners and managers of both small and large properties, as well as a variety of tenants and tenant advocates. **Attachment C** summarizes the public and stakeholder meetings pertaining to this issue. Public comments are included as **Attachment D**.

POLICY ALTERNATIVES

Alternative #1:	No changes be made to the Ellis Act Ordinance to reduce the requirement that all new apartments be re-controlled.
Pros:	Be consistent with all other California jurisdictions.
Cons:	Developers may see this alternative as a disincentive to proceed with the project. For the newly developed apartments, rent increases would be limited and result in financial implications with other comparable apartments that are market rate.
Reason for not recommending:	The development of additional housing is needed for residents in San José, and this alternative may provide a disincentive to invest in redeveloping ARO older housing stock.

Alternative #2:	Require relocation benefits for apartments built after 1979
Pros:	Creates consistency between all apartments covered by the Ellis Act Ordinance.
Cons:	Since these apartments are not subject to provisions in the Apartment Rent Ordinance, they are paying market rents. Findings would need to be made to determine a need for payment to tenants living in apartments built after 1979. This changes the findings previously made for tenants covered by the Apartment Rent Ordinance prior to Ellis Act removal.
Reason for not recommending:	Findings have not been made. Tenants living in apartments built after 1979 will be provided advanced notice and access to relocation consulting services.

EVALUATION AND FOLLOW-UP

The Ellis Act Ordinance will have a second reading by the City Council two weeks following the first reading of the ordinance. The updated ordinance will be effective 30 days following the second reading of the City Council. Adoption of this recommendation will complete the Administration's work on the City Council's top priority as it pertains to the Ellis Act.

COST IMPLICATIONS

The administration of the Ellis Act Ordinance will be funded through a filing fee required by property owners upon filing a Notice of Intent to Withdraw. This requirement would be extended to owners of three apartments or more. The fee is based on the assessment of work required by staff. It includes relocation specialist costs. Implementation of the Ellis Act Ordinance will be supported by the current staffing levels of the Rent Stabilization Program. The fee will be reviewed on an annual basis as a part of the City's annual Fees and Charges recommendations.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

Pursuant to Section 7.01 of the existing regulations, the proposed amendments to the Ellis Act Ordinance were presented to the Housing and Community Development Commission (HCDC) at their regularly scheduled meeting on March 22, 2018. These reports and attachments is available at the following link: http://www.sanjoseca.gov/index.aspx?NID=1265 The HCDC supported the staff recommendation, while expressing a desire to increase the affordable housing option to a 25% requirement and deepening the affordability of the additional affordable housing apartments to 80% AMI. The revised recommendation from HCDC is summarized below:

Amend the Ellis Act Ordinance re-control provisions to:

A. Subject the greater of either 50% of new apartments built *or* the number of apartments removed from the market, to the Apartment Rent Ordinance (ARO);
B. Allow an exemption from the re-control provisions if at least twenty-five (25) newly constructed rental units are being created, the re-control requirement under this Section will be waived in the event that the Owner:
   i. develops fifteen percent (15%) of the newly constructed units as on-site affordable rental units consistent with the standards and affordability restriction requirements in the Inclusionary Housing Ordinance, Chapter 5.08 of Title 5 of the San José Municipal Code and its implementing guidelines; and
   ii. develops an additional ten percent (10%) of the newly constructed units as on-site affordable rental units restricted at 80% of area median income, but otherwise consistent with the standards in the Inclusionary Housing Ordinance and implementing guidelines.

2. Include apartments buildings with three units under the Ellis Act.
3. Require apartments with three units or more built after 1979 to provide 120-day notification to their tenants and the City and to provide relocation consultant services to impacted tenants.

CEQA

Not a Project, File No. PP17-008, General Procedure & Policy Making resulting in no changes to the physical environment.

/s/
JACKY MORALES-FERRAND
Director of Housing

For questions, please contact Rachel VanderVeen, Program Administrator, at (408) 535-8231.

ATTACHMENTS:
Attachment A – Potential Projects Subject to Removal under Ellis Act Ordinance
Attachment B – David Paul Rosen and Associates Report "Assessing the Potential Effect of the ARO on New Development"
Attachment C – Ellis Act Ordinance Community and Stakeholder Meetings
Attachment D – Ellis Act Ordinance Public Comments

ORDINANCE NO. ____________

AN ORDINANCE OF THE CITY OF SAN JOSE AMENDING PART 11 OF CHAPTER 17.23 OF TITLE 17 OF THE SAN JOSE MUNICIPAL CODE TO ADD THREE UNIT BUILDINGS, TO MODIFY RE-CONTROL PROVISIONS, AND TO PROVIDE THAT OTHER MULTIFAMILY UNITS ARE DEEMED TO HAVE MET OBLIGATIONS UNDER THIS PART AFTER COMPLIANCE WITH NOTICE AND RELOCATION SPECIALIST OBLIGATIONS

WHEREAS, the purpose of the Apartment Rent Ordinance, parts 1-9 of chapter 17.23, Title 17 of the San José Municipal Code is to promote stability and fairness within the residential rental market in the City, thereby serving the public peace, health, safety, and public welfare and to protect tenants from excessive and unreasonable rent increases.

WHEREAS, on May 10, 2016, as part of the policies adopted to strengthen the Apartment Rent Ordinance, the City Council directed staff to develop a local Ellis Act Ordinance to address the removal of rent stabilized properties from the rental market.

WHEREAS, on April 18, 2017, City Council approved an Ellis Act Ordinance that established a process by which a property owner can remove their apartments subject to the Apartment Rent Ordinance from the rental market and procedures for re-control - subjecting apartments returned to the rental market or apartments constructed on the property after demolition ("replacement apartments") within five years of withdrawal to the Apartment Rent Ordinance.

WHEREAS, the City Council provided directed staff to return with additional research regarding other jurisdiction's Ellis Act Ordinances and the impact of subjecting all replacement apartments to re-control.

WHEREAS, staff conducted public meetings and individual stakeholder meetings, engaged a consultant to complete a study on potential impacts of re-control on development, and completing research on Ellis Act provisions from other jurisdictions

WHEREAS, staff's study concluded that the Apartment Rent Ordinance's allowed annual general increase of 5% was not likely to have an impact on first mortgage lenders, but that some junior lenders were concerned about unpredictability and some jurisdictions that re-controlled all replacement apartments were more likely to have demolished rent stabilized apartments replaced by other uses such as for-sale units that would not be subject to re-control.

WHEREAS, staff's research also indicated that both tenants and lenders prefer the certainty of affordability restricted apartments, and thus staff is recommending adding a provision which allows a developer to avoid the re-control requirements by voluntarily complying with the on-site affordable rental requirement of the Inclusionary Housing Ordinance, Chapter 5.08 of Title 5, and voluntarily agreeing to provide additional restricted rental units on-site.

WHEREAS, experience with the current Ellis Act Ordinance and the Tenant Protection Ordinance, Part 12 of Chapter 17.23 of Title 17 of the San José Municipal Code, which limits causes of eviction indicated that in order to allow owners of three unit apartments subject to the Apartment Rent Ordinance to use the Tenant Protection Ordinance's Ellis Act just cause for eviction, and to allow all tenants of rent stabilized units to enjoy the same protections, the Ellis Act's threshold should be set at three, rather than four units.

WHEREAS, experience with the current Ellis Act Ordinance and the Tenant Protection Ordinance, indicated that it would be helpful to allow owners of apartments that are not subject to the Apartment Rent Ordinance to voluntarily comply with the Ellis Act Ordinance's provisions regarding notice and a relocation specialist.

NOW, THEREFORE, BE IT ORDAINED BY THE COUNCIL OF THE CITY OF SAN JOSE:

SECTION 1. Section 17.23.1130 of Chapter 17.23 of Title 17 of the San José Municipal Code is hereby amended to read as follows:

"17.23.1130 General

A. Fees. The City shall establish fees for City-incurred costs which shall be paid by any Owner who exercises the privilege to withdraw Covered Units from rent or lease. The City shall set the fee so as to recover all costs of administering this Part. The fees shall be paid to the City prior to the service of the Notice of Intent to Withdraw on any Tenant. Failure to pay the fees prior to service of the Notice of Intent to Withdraw shall invalidate such notice.

B. Copies of Forms. Owner shall make copies of notices and forms available if a Tenant indicates the items have been misplaced or lost or are otherwise needed.

C. New Tenants During the Withdrawal Process. If the Owner desires to rent a Covered Unit to a new occupant after delivery of the Notice of Intent to Withdraw, the Owner shall comply with this subsection). Owner shall first comply with all requirements of this Part 11, including but not limited to the delivery of notices to the City and Tenants, and the provision of Relocation Assistance in accordance with Section 17.23.1150 with respect to the unit to be rented. Prior to such rental, Owner shall also provide a Notice of Pending Withdrawal on a City approved form to any new potential occupant of the Covered Unit for acknowledgement. If the Owner complies with this subsection, the new occupant shall not be entitled to Relocation Assistance or other benefits under this Part. If the Owner fails to comply, the new occupant of the Covered Unit shall be entitled to Relocation Assistance under this Part.

D. City Approved Forms. Director may adopt such forms as are necessary or convenient for the administration of this Part 11, subject to review and approval of the City Attorney.

E. Every Owner must provide to each Tenant of a Covered Unit a notice of Tenant rights to extend the tenancy on a form specified by the City, which may include contact information for the City and shall include the following statement:

"In accordance with the State's Ellis Act, the City of San José requires landlords to allow certain tenants to extend their tenancy beyond the minimum one hundred twenty (120) day notice period when a landlord intends to withdraw the dwelling unit from the residential rental market. The elderly, disabled, and households with a child enrolled in kindergarten through 12th grade may be eligible for extended tenancies if requested."

F. Withdrawal of less than an entire building is not allowed under this Part.

G. The City Manager may adopt regulations for the administration of this Part.

H. ~~Three Unit Properties. Notwithstanding any other provision of this Part, this Part shall not apply to properties with a total of no more than three (3) Covered Units.~~ Non-Rent Stabilized Properties. Property with three (3) or more units that does not contain any Covered Units may be permanently withdrawn from the residential rental market. Such a permanent withdrawal made in good faith will be consistent with this Part, if the Owner has completed all of the following as described this Part and the Regulations: (i) served Notices of Intent to Withdraw on the Tenants and the City, (ii) complied with the provisions of Section 17.23.1160 requiring 120 day notice for all Tenants and Extended Notice for certain Tenants prior to termination of tenancy, and (iii) paid the filing fee including the fee for Relocation Specialist Services described in Section 17.23.1150.E. Upon completion of these requirements and expiration of the notice periods, the Owner will be considered to have met the relocation obligations of this Part for the purposes of evaluation for demolition permits under Section 20.200.460 and for the purposes of satisfying the requirements for relocation under the Tenant Protection Ordinance, Sections 17.23.1250.A.9 and 17.23.1250.B.2. These properties shall not be subject to the requirement to pay Base or Qualified Assistance, to provide the Tenant Qualification forms, to record a memorandum regarding re-control, or to provide a right of return.

SECTION 2. Section 17.23.1180 of Chapter 17.23 of Title 17 of the San José Municipal Code is hereby amended to read as follows:

17.23.1180 Re-Control

A. If a building containing a Covered Unit is withdrawn from the residential rental market and is returned by an Owner to the residential rental market within five (5) years, then that unit must be offered and rented or leased at the lawful rent in effect at the time the Notice of Intent to Withdraw was delivered to the City, plus any annual adjustments authorized by Title 17, Chapter 23 of this Code. This Section applies regardless of the occupancy status of each Covered Unit when the building was withdrawn from the residential rental market and regardless of whether a displaced Tenant exercises a Right to Return.

B. If a building containing a Covered Unit is demolished and new unit(s) are built on the same property and offered for rent or lease within five (5) years of the effective date of withdrawal of the building containing the Covered Unit, the number of newly constructed rental units equal to greater of (i) the number of Covered Units or (ii) fifty percent (50%) of all newly constructed rental units located on the property where the Covered Unit was demolished shall be deemed Rent Stabilized Units subject to the Apartment Rent Ordinance, Title 17, Chapter 23 of this Code. Any new units made subject to the Apartment Rent Ordinance which are in excess of the number of demolished Covered Units shall remain subject to the Annual General Increase limit of the monthly Rent charged for the previous twelve (12) months for the Rent Stabilized Unit multiplied by five percent (5%) in the event that Section 17.23.310.B is amended to change the Annual General Increase limit. ~~The City Council may, by resolution, adopt a rule to exempt some or all of the new units in excess of the number of demolished Covered Units from the requirement for re-control.~~

C. Waiver for Projects with On-Site Affordable Units. If at least twenty (20) newly constructed rental units are being created, the re-control requirement under this Section will be waived in the event that the Owner:

(i) develops fifteen percent (15%) of the newly constructed units as on-site affordable rental units consistent with the standards and affordability restriction requirements in the Inclusionary Housing Ordinance, Chapter 5.08 of Title 5 of the San Jose Municipal Code and its implementing guidelines; and

(ii) develops an additional five percent (5%) of the newly constructed units as on-site affordable rental units restricted at 100% of area median income, but otherwise consistent with the standards in the Inclusionary Housing Ordinance and implementing guidelines.

ADOPTED this ______ day of _______, 2018, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

SAM LICCARDO
Mayor

ATTEST:

TONI TABER, CMC
City Clerk

Potential Projects Subject to Removal under
Ellis Act Ordinance

#	Property Address	Permit #	Comment
1	4094 Hamilton	CP15-081	Permit approved
2	373 E. San Fernando St.	CP17-013	Inquiry
3	7201 Bark Ln.	PDC17-035 PRE16-153	Inquiry
4	2050 Southwest Expwy.	PDC17-059	Inquiry
5	439 and 451 S. 4th St.	H17-004	Inquiry
6	1605 Parkmoor Ave	H17-001	Inquiry

As of 3/15/18

ATTACHMENT B

DRA DAVID PAUL ROSEN & ASSOCIATES
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March 28, 2018

To: Kristen Clements

From: Nora Lake-Brown, David Rosen

Subject: Assessing the Potential Effect of the ARO on New Development

This memo summarizes findings from DRA's analysis of the potential effect of ARO obligations on demolished ARO housing properties that are rebuilt with new market rate housing. DRA focused on the potential difference in cash flows, property valuation and supportable debt under alternative restrictions and the extent to which the financing of new market rate housing construction is affected.

To complete this assignment DRA conducted interviews with representatives of private debt and mezzanine debt/equity sources, using the interviewee list and interview questions outlined in DRA's memo dated February 9, 2018. DRA prepared a financial analysis of prototypical rental developments and calculated supportable first mortgage financing using financing terms and underwriting standards consistent with GSE multifamily loan programs. DRA also compared trends in San Jose apartment rents with the 5% cap on ARO units.

SUMMARY OF FINDINGS

In its lender and investor interviews and analysis, DRA focused on the following key questions regarding the effect of ARO restrictions on the financing of new multifamily housing development[1]:

1. How do the ARO restrictions affect the sizing of the senior first mortgage?
2. How do the ARO restrictions affect subordinate mezzanine debt/equity financing?
3. How do historical rent trends in San Jose compare to the 5% cap under the ARO?

---

[1] These interviews will inform DRA's middle income debt fund analysis as well as the ARO analysis.

DRA completed the following lender and investor interviews for this assignment:

- Andrew Ditton at Citibank;
- Stephanie McFadden at CBRE (formerly at Union Bank);
- Kenji Tamaoki at Prudential;
- Bob Simpson and Angela Kelcher at Fannie Mae.

Effect on First Mortgage Financing

In terms of first mortgage financing, the key underwriting factors affecting first mortgage sizing include the DSCR, mortgage interest rate, loan to value ratio, and escalation rates and cap rates used to determine projected value upon exit. Current term sheets for FreddieMac and FannieMae fixed-rate multifamily loans are attached to this memo.

Due to GSE underwriting standards of 2% escalation on revenues and 3% on costs for the purpose of the refinancing test, the 5% annual cap on rent increases imposed by the ARO does not affect the sizing of the first mortgage. Standard fixed-rate mortgage products for conventional multifamily properties from both FannieMae and FreddieMac require a loan-to-value (LTV) ratio of no more than 80% and a minimum debt service coverage ratio (DSCR) of 1.25. Based on our cash flow analysis, first mortgage financing on new multifamily construction in San Jose is currently constrained primarily by DSCR, rather than LTV requirements.

Our lender interviews confirmed that ARO rent caps would have no effect on first mortgage financing for new apartment construction. Lenders further confirmed that any effects ARO rent caps might have on subordinate mezzanine debt/equity financing would not affect senior mortgage financing.

DRA also confirmed through its interviews that mezzanine lenders and investors use similar escalators and refinancing tests in assessing the viability of mezzanine debt and equity investments as conventional lenders. Therefore, the sizing of mezzanine debt or equity is not directly affected by ARO rent caps. One lender mentioned that there may be a perception that ARO rent caps subject multifamily property owners to limitations on the “upside” while providing full exposure to "downside" risks. This is despite the fact that there is no 10-year period (the length of time typically used for the refinance test) since 1970 where market rents have increased by more than an average of 5% per year, as described in the next section.[1]

The perception of a limit on upside potential, however, may lead to ARO projects being viewed slightly less competitively by lenders and investors than projects without ARO restrictions, all other factors being equal. We uncovered no evidence of a lack of liquidity for such projects, however, ARO projects may receive slightly less competitive pricing. Given the number of economy-wide and project-specific factors that affect pricing and investment, it is not possible to isolate or quantify the amount, if any, of this pricing effect.

Historical Rent Trends in San Jose

Comparing historical trends in apartment rents in San Jose with the 5% annual cap imposed by the ARO sheds light on the potential effect of ARO restrictions on underwriting of subordinate debt and equity. **Table 1** and **Charts 1** and **2** on the following pages show the annual percentage increase in the average effective monthly rent per unit and average effective monthly rent per square foot[2], along with the Consumer Price Index for all urban consumers for rent (CPI-U Rent), from 2006 through 2017. Since 2009, the lowest point in the market during this period, the average annual increase in monthly rents has been 3.5%, well below the 5% ARO cap. Additional data on the CPI-U Rent back to 1970 indicates the average annual increase over the past 46 years has averaged 4.9%. With these rent trends, it would be difficult to support underwriting projected rent increases over 5% per year.

[1]Based on analysis of CPI-U Rent data since 1970 and CoStar rent data since 2006.

[2]For 4 and 5 star properties as rated by CoStar (5 stars is the highest rating).

Table 1
Annual Percentage Increase in Apartment Rents[1] and the Consumer Price Index
2006 to 2017

	Effective Monthly Rent Per Unit[1]		Effective Monthly Rent Per Square Foot[1]		
Year	**$**	**Annual Change**	**$**	**Annual Change**	**CPI-U Rent)**
2006	$2,172	--	$1.83	--	--
2007	$2,348	8.1%	$2.00	9.3%	3.9%
2008	$2,379	1.3%	$2.06	3.0%	4.1%
2009	$2,171	-8.7%	$1.86	-9.7%	3.2%
2010	$2,278	4.9%	$1.95	4.8%	-0.1%
2011	$2,353	3.3%	$2.03	4.1%	2.3%
2012	$2,449	4.1%	$2.15	5.9%	4.1%
2013	$2,599	6.1%	$2.28	6.0%	4.5%
2014	$2,721	4.7%	$2.45	7.5%	5.5%
2015	$2,823	3.7%	$2.66	8.6%	6.1%
2016	$2,782	-1.5%	$2.68	0.8%	--
2017	$2,869	3.1%	$2.75	2.6%	--
2009 - 2017	**--**	**3.5%**	**--**	**3.3%**	**3.7%**

[1]Includes 4- and 5-star properties as rated by CoStar (5 stars is the highest rating).
Source: CoStar; City of San Jose, DRA.

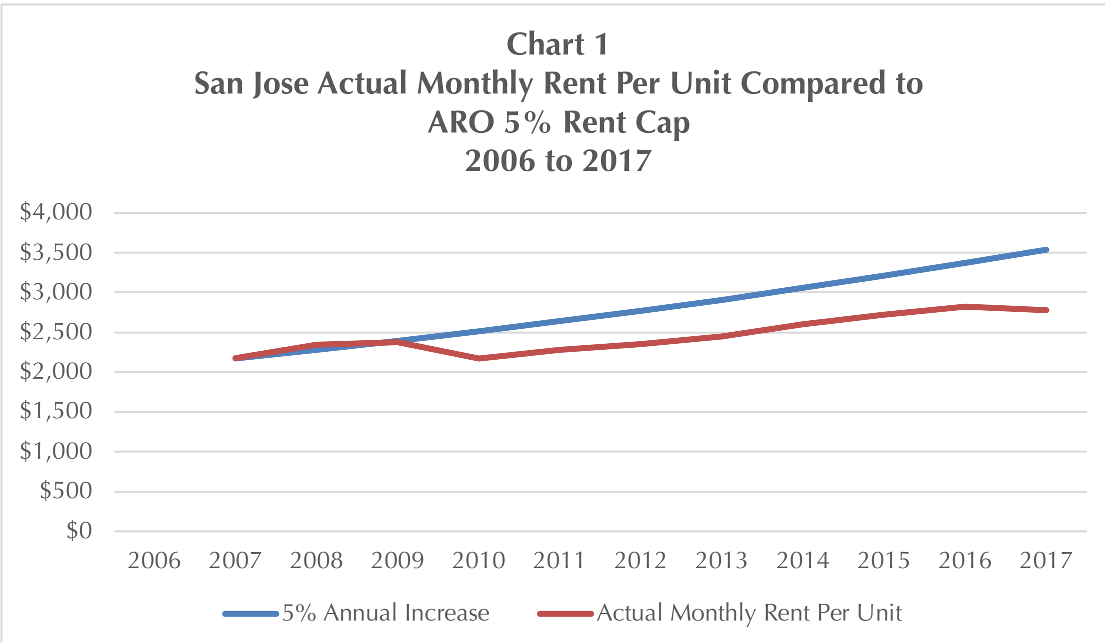
Chart 1
San Jose Actual Monthly Rent Per Unit Compared to
ARO 5% Rent Cap
2006 to 2017
$4,000
$3,500
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$0
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
5% Annual Increase
Actual Monthly Rent Per Unit

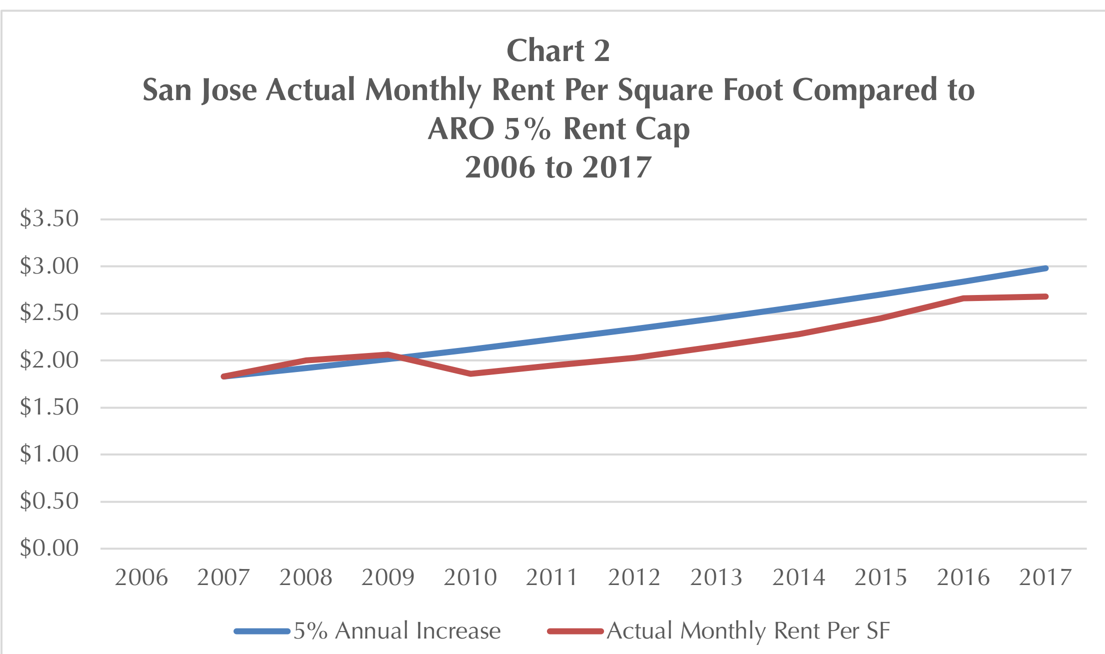
Chart 2
San Jose Actual Monthly Rent Per Square Foot Compared to
ARO 5% Rent Cap
2006 to 2017
$3.50
$3.00
$2.50
$2.00
$1.50
$1.00
$0.50
$0.00
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
5% Annual Increase
Actual Monthly Rent Per SF

CASH FLOW ANALYSIS

DRA prepared a cash flow analysis estimating the supportable first mortgage financing from prototypical newly constructed multifamily apartment projects using:

- Loan terms (LTV, DSCR), escalation rates (2% on revenues; 3% on operating costs), and current interest rates[1] for multifamily fixed rate mortgages used by FannieMae and FreddieMac (estimated at 5% for 30-year amortization).
- Data from CoStar on average rents by unit bedroom count and subarea within the City of San Jose for apartment properties constructed since 2015, representing rents for newly constructed properties. CoStar data were used to create prototypical housing developments (in terms of total units, unit bedroom count distribution, square footages and rents) for the five geographic market subareas of San Jose defined by CoStar.
- Operating cost data for conventional apartment properties in San Jose from the Institute of Real Estate Management, by housing product type.

Table 2 on the next page summarizes the financing assumptions used in the analysis. **Table 3** on the following page summarizes rent and operating costs assumptions.

Since we have concluded that ARO restrictions have no effect on first mortgage sizing or refinance tests used by GSE lenders, the percentage of ARO replacement units (100%, or 200% of demolished AMO units) has no effect on these cash flow projections. The projections assume that the project's Citywide inclusionary housing requirement is met through an alternative compliance method, such as payment in lieu, and does not contain on-site inclusionary units.

Appendix A contains the detailed financial analysis, including **Table 4**, which describes the rental prototypes in terms of unit sizes and bedroom count distribution, cash flow projections for each prototype, followed by current FannieMae and FreddieMac fixed rate multifamily loan term sheets.

---

1 5% interest rate for 30-year amortization, FannieMae fixed-rate loan, Feb. 16, 2018.

Table 2
Cash Flow and Financing Assumptions
San Jose ARO Analysis

Escalation Rates: Underwriting and Refinance Analysis	
Unregulated Rents	2.0%
ARO Rents	2.0%
Inclusionary Rents	2.0%
Laundry/Misc. Income	3.0%
Retail Income	3.0%
Operating Costs	3.0%
Cap Rates	
Entry Cap Rate	5.0%
Exit Cap Rate	7.0%
Financing Assumptions	
First Mortgage Interest Rate	6.0%
Amortization Period	30 years
Debt Service Coverage Ratio (DSCR)	1.25
Loan to Value (LTV) Ratio	80%
Refinance Assumptions	
Interest Rate	7.0%
Amortization Period	30 years
DSCR	1.25
LTV	80%

Sources: Lender and investor interviews; GSE term sheets; DRA.

DAVID PAUL ROSEN & ASSOCIATES
DEVELOPMENT, FINANCE AND POLICY ADVISORS

Table 3
Monthly Rent Per Square Foot and Annual Operating Cost Assumptions
San Jose ARO Analysis

	Downtown San Jose	West San Jose	Outer North San Jose	South San Jose	East San Jose
Studio	--	--	$3.60	$3.60	$3.95
One BR	$3.33	$3.33	$3.33	$3.00	$3.33
Two BR	$2.80	$2.80	$2.80	$2.60	$2.30
Three BR	--	--	$3.00	$2.45	
Average	$3.07	$3.13	$3.09	$2.80	$2.88
Operating Costs/SF	$14.20	$14.20	$14.20	$9.25	$9.25
Operating Costs/Unit	$12,894	$12,141	$13,362	$8,233	$7,770

[1]Rent assumptions from CoStar for properties built 2015 through 2017. Based on average monthly rent by submarket area and unit bedroom count.
[2]Total annual operating expenses per square foot, including property taxes, from Institute of Real Estate Management 2017 Income/Expense Analysis for San Jose.
Sources: CoStar; IREM; City of San Jose; DRA.

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Appendix A
Assessing the Potential Effect of the ARO on New Development
City of San Jose

3/28/18

List of Tables

San Jose ARO Analysis

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Table 1
City of San Jose
Apartment Rent Trends
4 and 5 Star Properties (1)

	Inventory (Units)	Effective Monthly Rent/Unit	Annual Change	Effective Monthly Rent/SF	Annual Change	Annual Change in CPI-U-Rent
2006	21,887	$2,172		$1.83		
2007	22,774	$2,348	8.1%	$2.00	9.3%	3.9%
2008	23,606	$2,379	1.3%	$2.06	3.0%	4.1%
2009	23,849	$2,171	-8.7%	$1.86	-9.7%	3.2%
2010	24,119	$2,278	4.9%	$1.95	4.8%	-0.1%
2011	24,656	$2,353	3.3%	$2.03	4.1%	2.3%
2012	27,410	$2,449	4.1%	$2.15	5.9%	4.1%
2013	30,524	$2,599	6.1%	$2.28	6.0%	4.5%
2014	33,820	$2,721	4.7%	$2.45	7.5%	5.5%
2015	39,178	$2,823	3.7%	$2.66	8.6%	6.1%
2016	42,147	$2,782	-1.5%	$2.68	0.8%	--
2017	43,843	$2,869	3.1%	$2.75	2.6%	--
2006-2017 (2)			2.6%		3.8%	
2007-2017 (2)			2.0%			3.7%
2008-2017 (2)			2.1%		3.2%	3.7%
2009-2017 (2)			3.5%		3.3%	3.7%
2010-2017 (2)			3.4%		5.0%	3.7%
2011-2017 (2)			3.4%		5.0%	4.5%
2011-2017 (2)			3.2%		5.2%	5.1%

(1) The CoStar Building Rating System is a national rating for commercial buildings. The highest rating is 5 stars.
(2) For the CPI-U Rent, annual changes are through 2015 rather than 2017.

Sources: CoStar; City of San Jose; DRA.

Table 2
Cash Flow and Financing Assumptions

Escalation Rates: Underwriting/Refinance Analysis	
Unregulated Rents	2.00%
ARO Rents	2.00%
Inclusionary Rents	2.00%
Laundry/Misc. Inc.	3.00%
Retail Income	3.00%
Operating Costs	3.00%
Cap Rates	
Entry Cap Rate	5.00%
Exit Cap Rate	7.00%
Financing Assumptions	
Interest Rate	5.00%
Amortization Term (Years)	30
DSCR	1.25
LTV	80%
Refinance Assumptions	
Interest Rate	7.00%
Amortization Term (Years)	30
DSCR	1.25
LTV	80%

Source: FannieMae and FreddieMac fixed-rate multifamily mortgage term sheets; lender interviews; DRA.

Table 3
Net Operating Income from Apartments
San Jose ARO Analysis

	Prototype 1	Prototype 2	Prototype 3	Prototype 4	Prototype 5
	Downtown San Jose	West San Jose	Outer North San Jose	South San Jose	East San Jose
Tenure	Rental	Rental	Rental	Rental	Rental
Net Rentable SF of Apartment Space	227,000	513,000	376,400	356,000	168,000
Net Rentable SF of Retail Space	0	8,000	0	0	0
Parking Spaces	0	945	0	0	0
Approximate Building Stories	0	4 & 5 Stories	0	0	0
Total Units	**250**	**600**	**400**	**400**	**200**
Unit Size (Square Feet)					
Studio/Loft	-	-	660	550	550
One Bedroom	780	750	800	750	750
Two Bedroom	1,100	1,100	1,100	1,100	1,050
Three Bedroom	-	-	1,300	1,300	-
Four Bedroom	-	-	-	-	-
Average	*908*	*855*	*941*	*890*	*840*
Monthly Rent Per SF (1)					
Studio/Loft			$3.60	$3.60	$3.95
One Bedroom	$3.33	$3.33	$3.33	$3.00	$3.33
Two Bedroom	$2.80	$2.80	$2.80	$2.60	$2.30
Three Bedroom			$3.00	$2.45	
Four Bedroom					
Total Units					
Average Monthly Rent/Unit	$3.07	$3.13	$3.09	$2.81	$2.88
Monthly Rent Per Unit					
Studio/Loft			$2,376	$1,980	$2,173
One Bedroom	$2,597	$2,498	$2,664	$2,250	$2,498
Two Bedroom	$3,080	$3,080	$3,080	$2,860	$2,415
Three Bedroom			$3,900	$3,185	
Four Bedroom					
Average Monthly Rent/Unit	$2,790	$2,672	$2,904	$2,500	$2,416
Average Monthly Rent Per Square Foot	$3.07	$3.13	$3.09	$2.81	$2.88
Parking Income ($/Space/Month)	$0	$0	$0	$0	$0
Parking Usage Rate	100%	100%	100%	100%	100%
Miscellaneous Income ($/Unit/Year)	$120	$120	$120	$120	$0
Stabilized Rental Vacancy Rate	7.0%	7.0%	7.0%	7.0%	7.0%
Rental Operating Cost/Unit	$12,894	$12,141	$13,362	$8,233	$7,770
Rental Operating Cost/SF (2)	$14.20	$14.20	$14.20	$9.25	$9.25
Retail Income ($/NSF/Year)		$65.00			
Retail Vacancy Rate (% Gross Retail Income)		0%			
Retail Operating Cost ($ Per NSF)		$10			
Total Monthly Gross Rental Income, Apts.	**$697,610**	**$1,603,350**	**$1,161,760**	**$999,800**	**$483,150**
Annual Gross Income	**$8,371,320**	**$19,240,200**	**$13,941,120**	**$11,997,600**	**$5,797,800**
Less: Apartment Vacancy	($585,992)	($1,346,814)	($975,878)	($839,832)	($405,846)
Plus: Retail Income	$0	$520,000	$0	$0	$0
Plus: Parking Income	$0	$0	$0	$0	$0
Plus: Misc. Income	$30,000	$72,000	$48,000	$48,000	$0
Adjusted Annual Gross Income	**$7,815,328**	**$18,485,386**	**$13,013,242**	**$11,205,768**	**$5,391,954**
Operating Costs					
Less: Apartment Operating Costs (2)	($3,223,400)	($7,284,600)	($5,344,880)	($3,293,000)	($1,554,000)
Less: Retail Operating Costs	$0	($80,000)	$0	$0	$0
Net Operating Income	**$4,591,928**	**$11,120,786**	**$7,668,362**	**$7,912,768**	**$3,837,954**

(1) From CoStar for properties built 2015 through 2017. Average by submarket area and unit bedroom count.
(2) Total expenses from Institute of Real Estate Management 2017 Income/Expense Analysis, including property taxes.
Assumes elevator served buildings for Prototypes 1, 2 and 3 and Garden Apartments, High Cost, for Prototypes 4 and 5.
Sources: CoStar; IREM; City of San Jose; DRA.

Table 4
Development Prototypes
San Jose ARO Analysis

	Prototype 1	Prototype 2	Prototype 3	Prototype 4	Prototype 5
Market Subarea:	**Downtown San Jose**	**West San Jose**	**Outer North San Jose**	**South San Jose**	**East San Jose**
Total Housing Unit Count	**250**	**600**	**400**	**400**	**200**
Original ARO Units	**100**	**200**	**200**	**200**	**100**
Other Regulated Units	**0**	**0**	**0**	**0**	**0**
Tenure (Renter/Owner)	Rental	Rental	Rental	Rental	Rental
New Construction or Conversion	New	New	New	New	New
Total Site Area (Acre)		7.68 Acres			
Total Site Area (SF)		334,541			
Density (Units Per Acre)		78			
Construction Type		Type III-A			
Parking Type		1.5 Levels Partially Subt.			
Building Stories		4 & 5 Stories			
Net Residential Square Feet (NRSF)	**227,000 SF**	**513,000 SF**	**376,400 SF**	**356,000 SF**	**168,000 SF**
Net SF Retail	0 SF	8,000 SF			
Other Uses (NSF)	0 SF	0 SF			
Net SF Total	227,000 SF	521,000 SF	376,400 SF	356,000 SF	168,000 SF
Other Uses (NSF)					
Building Efficiency Ratio (%)	78%	78%	571%	571%	80%
Total Gross Building SF (Excl. Pkg.)	291,026	667,949	65,864	62,294	210,000
Unit Bedroom Count Distribution (1)					
Studio/Loft	0%	0%	10%	10%	15%
One Bedroom	60%	70%	45%	50%	45%
Two Bedroom	40%	30%	35%	30%	40%
Three Bedroom	0%	0%	10%	10%	0%
Four Bedroom	0%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%
Units by BR Count					
Studio/Loft			40	40	30
One Bedroom	150	420	180	200	90
Two Bedroom	100	180	140	120	80
Three Bedroom			40	40	
Four Bedroom					
Total Residential Units	250	600	400	400	200
Unit Size (Net SF) (1)					
Studio/Loft			660 SF	550 SF	550 SF
One Bedroom	780 SF	750 SF	800 SF	750 SF	750 SF
Two Bedroom	1,100 SF	1,100 SF	1,100 SF	1,100 SF	1,050 SF
Three Bedroom			1,300 SF	1,300 SF	
Four Bedroom					
Average Unit Size	*908 SF*	*855 SF*	*941 SF*	*890 SF*	*840 SF*
Underground Parking Spaces		945 Spaces			
Structured Parking Spaces					
Podium Parking Spaces					
Garage Parking Spaces					
Surface/Carport Parking Spaces					
Total Parking Spaces Provided		**945 Spaces**			
Actual Project:		The Reserve			

(1) From CoStar. Average by submarket area.
Sources: CoStar; DRA.

Table 5
Cash Flow Projections
Prototype 1 Downtown San Jose
100% ARO Replacement
San Jose ARO Analysis

Total Housing Units	250
Unregulated Units	112
ARO Units	100
Inclusionary Units	38
Other Regulated Units	0

Escalation Rates		**Cap Rates**		**Financing Assumptions**		**Refinance Assumptions**	
Market Rents (non-ARO)	2.00%	Entry Cap Rate	5.00%	Interest Rate	5.00%	Interest Rate	7.00%
ARO Rents	2.00%	Exit Cap Rate	7.00%	Amortization	30	Amortization	30
Inclusionary Rents	2.00%			DSCR	1.25	DSCR	1.25
Other Restricted Rents	2.00%			LTV	80%	LTV	80%
Laundry/Miscellaneous Income	3.00%						
Retail Income	3.00%						
Operating Costs	3.00%						

Year		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
CASH FLOW																
Revenues																
Gross Potential Rent																
Market-Rate Rental Income		$3,750,351	$3,825,358	$3,901,866	$3,979,903	$4,059,501	$4,140,691	$4,223,505	$4,307,975	$4,394,134	$4,482,017	$4,571,657	$4,663,091	$4,756,352	$4,851,479	$4,948,509
Inclusionary Units		$611,880	$624,118	$636,600	$649,332	$662,319	$675,565	$689,076	$702,858	$716,915	$731,253	$745,878	$760,796	$776,012	$791,532	$807,363
ARO Units		$3,348,528	$3,415,499	$3,483,809	$3,553,485	$3,624,554	$3,697,045	$3,770,986	$3,846,406	$3,923,334	$4,001,801	$4,081,837	$4,163,474	$4,246,743	$4,331,678	$4,418,312
Other Restricted Units		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous		$30,000	$30,900	$31,827	$32,782	$33,765	$34,778	$35,822	$36,896	$38,003	$39,143	$40,317	$41,527	$42,773	$44,056	$45,378
Retail Income		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Apartment Vacancy Allowance	7.00%	($539,753)	($550,548)	($561,559)	($572,790)	($584,246)	($595,931)	($607,850)	($620,007)	($632,407)	($645,055)	($657,956)	($671,115)	($684,538)	($698,228)	($712,193)
Retail Vacancy Allowance	5.00%	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Rental Income		$7,201,006	$7,345,326	$7,492,542	$7,642,711	$7,795,893	$7,952,149	$8,111,539	$8,274,128	$8,439,980	$8,609,159	$8,781,734	$8,957,772	$9,137,343	$9,320,517	$9,507,368
Operating Costs		($3,223,400)	($3,320,102)	($3,419,705)	($3,522,296)	($3,627,965)	($3,736,804)	($3,848,908)	($3,964,375)	($4,083,307)	($4,205,806)	($4,331,980)	($4,461,939)	($4,595,798)	($4,733,672)	($4,875,682)
Net Operating Income		$3,977,606	$4,025,224	$4,072,837	$4,120,415	$4,167,928	$4,215,344	$4,262,631	$4,309,753	$4,356,673	$4,403,354	$4,449,754	$4,495,832	$4,541,545	$4,586,846	$4,631,686
Debt Service--First Trust Deed		($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)	($3,182,085)
Debt Coverage Ratio		1.25	1.26	1.28	1.29	1.31	1.32	1.34	1.35	1.37	1.38	1.40	1.41	1.43	1.44	1.46
Net Cash Flow		$795,521	$843,139	$890,752	$938,330	$985,843	$1,033,259	$1,080,546	$1,127,668	$1,174,588	$1,221,269	$1,267,669	$1,313,747	$1,359,460	$1,404,761	$1,449,601

Capitalized Value, Cap Rate of:	5.00%	$79,552,124
MAX. 1ST MORTGAGE BASED ON DSCR		$49,396,994
MAX 1ST MORTGAGE BASED ON LTV		$63,641,699
PROJECT VALUE LESS FIRST MORTGAGE		$30,155,130

REFINANCE TESTS

	Refinance in Year 10	**Refinance in Year 15**
NOI	$4,403,354	$4,631,686
Cap Rate	7.00%	7.00%
Project Value	$62,905,051	$66,166,948
Max Loan Based on LTV	$50,324,040	$52,933,559
Max Loan Based on DSCR	$44,123,824	$46,411,834
Refinance Proceeds	$44,123,824	$46,411,834
Less: Outstanding Debt	$40,180,535	$33,532,611
Cash Out	$3,943,289	$12,879,224

Source: DRA

Table 6
Cash Flow Projections
Prototype 2 West San Jose
100% ARO Replacement
San Jose ARO Analysis

Total Housing Units	600
Unregulated Units	310
ARO Units	200
Inclusionary Units	90
Other Regulated Units	0

Escalation Rates		**Cap Rates**		**Financing Assumptions**		**Refinance Assumptions**	
Market Rents (non-ARO)	2.00%	Entry Cap Rate	5.00%	Interest Rate	5.00%	Interest Rate	7.00%
ARO Rents	2.00%	Exit Cap Rate	7.00%	Amortization	30	Amortization	30
Inclusionary Rents	2.00%			DSCR	1.25	DSCR	1.25
Other Restricted Rents	2.00%			LTV	80%	LTV	80%
Laundry/Miscellaneous Income	3.00%						
Retail Income	3.00%						
Operating Costs	3.00%						

Year		1	2	3	4	5	6	7	8
CASH FLOW									
Revenues									
Gross Potential Rent									
Market-Rate Rental Income		$9,940,770	$10,139,585	$10,342,377	$10,549,225	$10,760,209	$10,975,413	$11,194,922	$11,418,820
Inclusionary Units		$1,431,900	$1,460,538	$1,489,749	$1,519,544	$1,549,935	$1,580,933	$1,612,552	$1,644,803
ARO Units		$6,413,400	$6,541,668	$6,672,501	$6,805,951	$6,942,070	$7,080,912	$7,222,530	$7,366,981
Other Restricted Units		$0	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous		$72,000	$74,160	$76,385	$78,676	$81,037	$83,468	$85,972	$88,551
Retail Income		$520,000	$535,600	$551,668	$568,218	$585,265	$602,823	$620,907	$639,534
Apartment Vacancy Allowance	7.00%	($1,245,025)	($1,269,925)	($1,295,324)	($1,321,230)	($1,347,655)	($1,374,608)	($1,402,100)	($1,430,142)
Retail Vacancy Allowance	5.00%	($26,000)	($26,780)	($27,583)	($28,411)	($29,263)	($30,141)	($31,045)	($31,977)
Net Rental Income		$17,107,045	$17,481,626	$17,837,356	$18,200,384	$18,570,860	$18,948,941	$19,334,782	$19,728,547
Operating Costs		($7,284,600)	($7,503,138)	($7,728,232)	($7,960,079)	($8,198,881)	($8,444,848)	($8,698,193)	($8,959,139)
Net Operating Income		$9,822,445	$9,978,488	$10,109,124	$10,240,305	$10,371,979	$10,504,093	$10,636,589	$10,769,408
Debt Service--First Trust Deed		($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)
Debt Coverage Ratio		1.25	1.27	1.29	1.30	1.32	1.34	1.35	1.37
Net Cash Flow		$1,964,489	$2,120,532	$2,251,168	$2,382,349	$2,514,023	$2,646,137	$2,778,633	$2,911,452

Year	9	10	11	12	13	14	15
CASH FLOW							
Revenues							
Gross Potential Rent							
Market-Rate Rental Income	$11,647,196	$11,880,140	$12,117,743	$12,360,098	$12,607,300	$12,859,446	$13,116,635
Inclusionary Units	$1,677,699	$1,711,253	$1,745,478	$1,780,388	$1,815,995	$1,852,315	$1,889,362
ARO Units	$7,514,320	$7,664,607	$7,817,899	$7,974,257	$8,133,742	$8,296,417	$8,462,345
Other Restricted Units	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous	$91,207	$93,944	$96,762	$99,665	$102,655	$105,734	$108,906
Retail Income	$658,720	$678,482	$698,837	$719,802	$741,396	$763,638	$786,547
Apartment Vacancy Allowance	($1,458,745)	($1,487,920)	($1,517,678)	($1,548,032)	($1,578,993)	($1,610,572)	($1,642,784)
Retail Vacancy Allowance	($32,936)	($33,924)	($34,942)	($35,990)	($37,070)	($38,182)	($39,327)
Net Rental Income	$20,130,399	$20,540,506	$20,959,040	$21,386,177	$21,822,095	$22,266,978	$22,721,011
Operating Costs	($9,227,913)	($9,504,751)	($9,789,893)	($10,083,590)	($10,386,098)	($10,697,681)	($11,018,611)
Net Operating Income	$10,902,485	$11,035,755	$11,169,147	$11,302,587	$11,435,997	$11,569,297	$11,702,400
Debt Service--First Trust Deed	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)	($7,857,956)
Debt Coverage Ratio	1.39	1.40	1.42	1.44	1.46	1.47	1.49
Net Cash Flow	$3,044,529	$3,177,799	$3,311,191	$3,444,631	$3,578,041	$3,711,341	$3,844,444

Capitalized Value, Cap Rate of:	5.00%	$196,448,902
MAX. 1ST MORTGAGE BASED ON DSCR		$121,982,730
MAX 1ST MORTGAGE BASED ON LTV		$157,159,122
PROJECT VALUE LESS FIRST MORTGAGE		$74,466,172

REFINANCE TESTS

	Refinance in Year 10	**Refinance in Year 15**
NOI	$11,035,755	$11,702,400
Cap Rate	7.00%	7.00%
Project Value	$157,653,644	$167,177,139
Max Loan Based on LTV	$126,122,915	$133,741,711
Max Loan Based on DSCR	$110,583,834	$117,263,950
Refinance Proceeds	$110,583,834	$117,263,950
Less: Outstanding Debt	$40,180,535	$33,532,611
Cash Out	$70,403,299	$83,731,339

Source: DRA

Table 7
Cash Flow Projections
Prototype 3 Outer North San Jose
100% ARO Replacement
San Jose ARO Analysis

Total Housing Units	400
Unregulated Units	140
ARO Units	200
Inclusionary Units	60
Other Regulated Units	0

Escalation Rates		**Cap Rates**		**Financing Assumptions**		**Refinance Assumptions**	
Market Rents (non-ARO)	2.00%	Entry Cap Rate	5.00%	Interest Rate	5.00%	Interest Rate	7.00%
ARO Rents	2.00%	Exit Cap Rate	7.00%	Amortization	30	Amortization	30
Inclusionary Rents	2.00%			DSCR	1.25	DSCR	1.25
Other Restricted Rents	2.00%			LTV	80%	LTV	80%
Laundry/Miscellaneous Income	3.00%						
Retail Income	3.00%						
Operating Costs	3.00%						

Year		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
CASH FLOW																
Revenues																
Gross Potential Rent																
Market-Rate Rental Income		$4,879,392	$4,976,980	$5,076,519	$5,178,050	$5,281,611	$5,387,243	$5,494,988	$5,604,888	$5,716,985	$5,831,325	$5,947,952	$6,066,911	$6,188,249	$6,312,014	$6,438,254
Inclusionary Units		$975,144	$994,647	$1,014,540	$1,034,831	$1,055,527	$1,076,638	$1,098,171	$1,120,134	$1,142,537	$1,165,387	$1,188,695	$1,212,469	$1,236,718	$1,261,453	$1,286,682
ARO Units		$6,970,560	$7,109,971	$7,252,171	$7,397,214	$7,545,158	$7,696,061	$7,849,983	$8,006,982	$8,167,122	$8,330,464	$8,497,074	$8,667,015	$8,840,356	$9,017,163	$9,197,506
Other Restricted Units		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous		$48,000	$49,440	$50,923	$52,451	$54,024	$55,645	$57,315	$59,034	$60,805	$62,629	$64,508	$66,443	$68,437	$70,490	$72,604
Retail Income		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Apartment Vacancy Allowance	7.00%	($897,757)	($915,712)	($934,026)	($952,707)	($971,761)	($991,196)	($1,011,020)	($1,031,240)	($1,051,865)	($1,072,902)	($1,094,360)	($1,116,248)	($1,138,573)	($1,161,344)	($1,184,571)
Retail Vacancy Allowance	5.00%	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Rental Income		$11,975,339	$12,215,326	$12,460,127	$12,709,839	$12,964,560	$13,224,391	$13,489,436	$13,759,798	$14,035,584	$14,316,904	$14,603,868	$14,896,590	$15,195,187	$15,499,775	$15,810,475
Operating Costs		($5,344,880)	($5,505,226)	($5,670,383)	($5,840,495)	($6,015,710)	($6,196,181)	($6,382,066)	($6,573,528)	($6,770,734)	($6,973,856)	($7,183,072)	($7,398,564)	($7,620,521)	($7,849,136)	($8,084,611)
Net Operating Income		$6,630,459	$6,710,100	$6,789,744	$6,869,344	$6,948,851	$7,028,211	$7,107,370	$7,186,269	$7,264,850	$7,343,048	$7,420,796	$7,498,027	$7,574,666	$7,650,638	$7,725,865
Debt Service--First Trust Deed		($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)	($5,304,367)
Debt Coverage Ratio		1.25	1.27	1.28	1.30	1.31	1.32	1.34	1.35	1.37	1.38	1.40	1.41	1.43	1.44	1.46
Net Cash Flow		$1,326,092	$1,405,732	$1,485,376	$1,564,977	$1,644,483	$1,723,843	$1,803,002	$1,881,902	$1,960,482	$2,038,680	$2,116,429	$2,193,659	$2,270,298	$2,346,271	$2,421,497

Capitalized Value, Cap Rate of:	5.00%	$132,609,186
MAX. 1ST MORTGAGE BASED ON DSCR		$82,342,178
MAX 1ST MORTGAGE BASED ON LTV		$106,087,348
PROJECT VALUE LESS FIRST MORTGAGE		$50,267,007

REFINANCE TESTS

	Refinance in Year 10	**Refinance in Year 15**
NOI	$7,343,048	$7,725,865
Cap Rate	7.00%	7.00%
Project Value	$104,900,679	$110,369,495
Max Loan Based on LTV	$83,920,543	$88,295,596
Max Loan Based on DSCR	$73,581,041	$77,417,061
Refinance Proceeds	$73,581,041	$77,417,061
Less: Outstanding Debt	$40,180,535	$33,532,611
Cash Out	$33,400,506	$43,884,451

Source: DRA

Table 8
Cash Flow Projections
Prototype 4 South San Jose
Scenario 1: 100% ARO Replacement
San Jose ARO Analysis

Total Housing Units	400
Unregulated Units	140
ARO Units	200
Inclusionary Units	60
Other Regulated Units	0

Escalation Rates		**Cap Rates**		**Financing Assumptions**		**Refinance Assumptions**	
Market Rents (non-ARO)	2.00%	Entry Cap Rate	5.00%	Interest Rate	5.00%	Interest Rate	7.00%
ARO Rents	2.00%	Exit Cap Rate	7.00%	Amortization	30	Amortization	30
Inclusionary Rents	2.00%			DSCR	1.25	DSCR	1.25
Other Restricted Rents	2.00%			LTV	80%	LTV	80%
Laundry/Miscellaneous Income	3.00%						
Retail Income	3.00%						
Operating Costs	3.00%						

Year		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
CASH FLOW																
Revenues																
Gross Potential Rent																
Market-Rate Rental Income		$4,199,160	$4,283,143	$4,368,806	$4,456,182	$4,545,306	$4,636,212	$4,728,936	$4,823,515	$4,919,985	$5,018,385	$5,118,753	$5,221,128	$5,325,550	$5,432,061	$5,540,702
Inclusionary Units		$969,492	$988,882	$1,008,659	$1,028,833	$1,049,409	$1,070,398	$1,091,805	$1,113,642	$1,135,914	$1,158,633	$1,181,805	$1,205,441	$1,229,550	$1,254,141	$1,279,224
ARO Units		$5,998,800	$6,118,776	$6,241,152	$6,365,975	$6,493,294	$6,623,160	$6,755,623	$6,890,736	$7,028,550	$7,169,121	$7,312,504	$7,458,754	$7,607,929	$7,760,087	$7,915,289
Other Restricted Units		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous		$48,000	$49,440	$50,923	$52,451	$54,024	$55,645	$57,315	$59,034	$60,805	$62,629	$64,508	$66,443	$68,437	$70,490	$72,604
Retail Income		$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Apartment Vacancy Allowance	7.00%	($781,722)	($797,356)	($813,303)	($829,569)	($846,161)	($863,084)	($880,346)	($897,952)	($915,911)	($934,230)	($952,914)	($971,973)	($991,412)	($1,011,240)	($1,031,465)
Retail Vacancy Allowance	5.00%	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Rental Income		$10,433,730	$10,642,885	$10,856,237	$11,073,871	$11,295,873	$11,522,331	$11,753,334	$11,988,974	$12,229,343	$12,474,538	$12,724,655	$12,979,794	$13,240,054	$13,505,539	$13,776,355
Operating Costs		($3,293,000)	($3,391,790)	($3,493,544)	($3,598,350)	($3,706,301)	($3,817,490)	($3,932,014)	($4,049,975)	($4,171,474)	($4,296,618)	($4,425,517)	($4,558,282)	($4,695,031)	($4,835,882)	($4,980,958)
Net Operating Income		$7,140,730	$7,251,095	$7,362,693	$7,475,521	$7,589,572	$7,704,841	$7,821,320	$7,938,999	$8,057,869	$8,177,920	$8,299,139	$8,421,511	$8,545,023	$8,669,658	$8,795,397
Debt Service--First Trust Deed		($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)	($5,712,584)
Debt Coverage Ratio		1.25	1.27	1.29	1.31	1.33	1.35	1.37	1.39	1.41	1.43	1.45	1.47	1.50	1.52	1.54
Net Cash Flow		$1,428,146	$1,538,511	$1,650,109	$1,762,937	$1,876,988	$1,992,257	$2,108,735	$2,226,415	$2,345,285	$2,465,336	$2,586,554	$2,708,927	$2,832,439	$2,957,073	$3,082,813

Capitalized Value, Cap Rate of:	5.00%	$142,814,607
MAX. 1ST MORTGAGE BASED ON DSCR		$88,679,120
MAX 1ST MORTGAGE BASED ON LTV		$114,251,686
PROJECT VALUE LESS FIRST MORTGAGE		$54,135,487

REFINANCE TESTS

	Refinance in Year 10	**Refinance in Year 15**
NOI	$8,177,920	$8,795,397
Cap Rate	7.00%	7.00%
Project Value	$116,827,431	$125,648,528
Max Loan Based on LTV	$93,461,945	$100,518,823
Max Loan Based on DSCR	$81,946,886	$88,134,315
Refinance Proceeds	$81,946,886	$88,134,315
Less: Outstanding Debt	$40,180,535	$33,532,611
Cash Out	$41,766,351	$54,601,705

Source: DRA

Table 9
Cash Flow Projections
Prototype 5 East San Jose
100% ARO Replacement
San Jose ARO Analysis

Total Housing Units	200
Unregulated Units	70
ARO Units	100
Inclusionary Units	30
Other Regulated Units	0

Escalation Rates		**Cap Rates**		**Financing Assumptions**		**Refinance Assumptions**	
Market Rents (non-ARO)	2.00%	Entry Cap Rate	5.00%	Interest Rate	5.00%	Interest Rate	7.00%
ARO Rents	2.00%	Exit Cap Rate	7.00%	Amortization	30	Amortization	30
Inclusionary Rents	2.00%			DSCR	1.25	DSCR	1.25
Other Restricted Rents	2.00%			LTV	80%	LTV	80%
Laundry/Miscellaneous Income	3.00%						
Retail Income	3.00%						
Operating Costs	3.00%						

Year		1	2	3	4	5	6	7	8
CASH FLOW									
Revenues									
Gross Potential Rent									
Market-Rate Rental Income		$2,029,230	$2,069,815	$2,111,211	$2,153,435	$2,196,504	$2,240,434	$2,285,243	$2,330,947
Inclusionary Units		$474,132	$483,615	$493,287	$503,153	$513,216	$523,480	$533,950	$544,629
ARO Units		$2,898,900	$2,956,878	$3,016,016	$3,076,336	$3,137,863	$3,200,620	$3,264,632	$3,329,925
Other Restricted Units		$0	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous		$0	$0	$0	$0	$0	$0	$0	$0
Retail Income		$0	$0	$0	$0	$0	$0	$0	$0
Apartment Vacancy Allowance	7.00%	($378,158)	($385,722)	($393,436)	($401,305)	($409,331)	($417,517)	($425,868)	($434,385)
Retail Vacancy Allowance	5.00%	$0	$0	$0	$0	$0	$0	$0	$0
Net Rental Income		$5,024,104	$5,124,586	$5,227,077	$5,331,619	$5,438,251	$5,547,016	$5,657,957	$5,771,116
Operating Costs		($1,554,000)	($1,600,620)	($1,648,639)	($1,698,098)	($1,749,041)	($1,801,512)	($1,855,557)	($1,911,224)
Net Operating Income		$3,470,104	$3,523,966	$3,578,439	$3,633,521	$3,689,211	$3,745,504	$3,802,399	$3,859,892
Debt Service--First Trust Deed		($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)
Debt Coverage Ratio		1.25	1.27	1.29	1.31	1.33	1.35	1.37	1.39
Net Cash Flow		$694,021	$747,883	$802,356	$857,438	$913,128	$969,422	$1,026,317	$1,083,809

Year	9	10	11	12	13	14	15
CASH FLOW							
Revenues							
Gross Potential Rent							
Market-Rate Rental Income	$2,377,566	$2,425,118	$2,473,620	$2,523,092	$2,573,554	$2,625,025	$2,677,526
Inclusionary Units	$555,521	$566,632	$577,964	$589,524	$601,314	$613,340	$625,607
ARO Units	$3,396,523	$3,464,454	$3,533,743	$3,604,418	$3,676,506	$3,750,036	$3,825,037
Other Restricted Units	$0	$0	$0	$0	$0	$0	$0
Laundry/Miscellaneous	$0	$0	$0	$0	$0	$0	$0
Retail Income	$0	$0	$0	$0	$0	$0	$0
Apartment Vacancy Allowance	($443,073)	($451,934)	($460,973)	($470,192)	($479,596)	($489,188)	($498,972)
Retail Vacancy Allowance	$0	$0	$0	$0	$0	$0	$0
Net Rental Income	$5,886,538	$6,004,269	$6,124,354	$6,246,841	$6,371,778	$6,499,214	$6,629,198
Operating Costs	($1,968,561)	($2,027,618)	($2,088,446)	($2,151,099)	($2,215,632)	($2,282,101)	($2,350,564)
Net Operating Income	$3,917,977	$3,976,651	$4,035,908	$4,095,742	$4,156,146	$4,217,112	$4,278,634
Debt Service--First Trust Deed	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)	($2,776,083)
Debt Coverage Ratio	1.41	1.43	1.45	1.48	1.50	1.52	1.54
Net Cash Flow	$1,141,895	$1,200,568	$1,259,825	$1,319,659	$1,380,063	$1,441,029	$1,502,551

Capitalized Value, Cap Rate of:	5.00%	$69,402,073
MAX. 1ST MORTGAGE BASED ON DSCR		$43,094,435
MAX 1ST MORTGAGE BASED ON LTV		$55,521,659
PROJECT VALUE LESS FIRST MORTGAGE		$26,307,638

REFINANCE TESTS

	Refinance in Year 10	**Refinance in Year 15**
NOI	$3,976,651	$4,278,634
Cap Rate	7.00%	7.00%
Project Value	$56,809,306	$61,123,338
Max Loan Based on LTV	$45,447,445	$48,898,670
Max Loan Based on DSCR	$39,848,054	$42,874,068
Refinance Proceeds	$39,848,054	$42,874,068
Less: Outstanding Debt	$40,180,535	$33,532,611
Cash Out	($332,481)	$9,341,457

Source: DRA

Ellis Act Ordinance – Community and Stakeholder Meetings

Community Meetings

Meeting	Date	Time	Location
Policy Development Community Meeting – Tenant Meeting	February 22, 2018	6:30-8:30 pm	Westminster Presbyterian Church
Policy Development Community Meeting	February 12, 2018	6:30-8:30 pm	Seven Trees Community Center
Housing & Community Development Commission	February 8, 2018	5:45 pm	San José City Hall – Wing Rooms
Policy Development Community Meeting	February 7, 2018	9:00-11:00 am	San José City Hall – Wing Rooms
ARO & TPO Educational Outreach	January 25, 2018	6:30-8:30 pm	Cypress Community Center
ARO & TPO Educational Outreach	January 19, 2018	2:00-4:00 pm	San José City Hall – Wing Rooms
ARO & TPO Educational Outreach	January 10, 2018	9:00-11:00 am	San José City Hall – Wing Rooms

Stakeholder Meetings

Stakeholder Meeting		
Stakeholder – Developers	March 16, 2018	Developer Roundtable
Stakeholder – Landlords	March 8, 2018	Bay Area Housing Network
Stakeholder – Developers	March 2, 2018	Greystar
Stakeholder – Developers	February 22, 2018	Silicon Valley Synergy
Stakeholder - Tenants	February 20, 2018	Renters' Coalition
Stakeholder - Landlords	February 15, 2018	California Apartment Association
Stakeholder - Landlords	February 12, 2018	California Apartment Association
Stakeholder - Tenants	February 6, 2018	Renters' Coalition
Stakeholder - Landlords	January 29, 2018	California Apartment Association
Stakeholder - Landlords	January 16, 2018	California Apartment Association
Stakeholder - Tenants	January 10, 2018	Renters' Coalition
Stakeholder - Landlords	December 15, 2017	California Apartment Association
Stakeholder - Tenants	December 13, 2017	Renters' Coalition

Ellis Act Ordinance

City of San José – Department of Housing

Public Comments Received from
February 2, 2018 to April 2, 2018

Policy Development Meeting Series
February 7, 2018 to February 22,2018
Dot Activity for Public Comments

Ellis #1: How many of the new apartments should be covered by the Apartment Rent Ordinance? Select one.		
	Tenant	**Landlord**
All new apartments	16	
All new apartments are re-controlled, with some apartments limited to 5% and the other apartments limited to 10% rent increase		1
Two times the number of apartments destroyed are covered		1
The number of apartments destroyed are covered		4
If the new building includes 20% affordable units, the entire building would be exempt from rent control	9	
Other	• Define what type of affordable • Why not more than 20% • Affrodable should be for low income, very low income • At least 50% should be affordable	None
	Let's build our own community.	

2-7-18 Public Meeting Comments Summary

Criminal Activity

- The Housing Dept. should take more active of a role to regarding neighborhood issues. Recent shooting in the Cadillac neighborhood. How can Housing assist landlords in these type of situations? TPO makes addressing crime more challenging.
- "Responsible Landlord Engagement Initiative (RLEI)" available for landlords that are fearful of retaliation.
- "Crime Free" is an approach used by many other cities. Why not try crime free in San Jose?
- When did the City Council discuss crime free housing?
- What proof is required by landlord for the 12 Just Cause?

RUBS

- Master metered electricity and gas – all references to RUBS assume landlords are only using RUBs for water, sewer and garbage. Landlords of older buildings also allocate gas and electric.
- Idea: Certified RUBs provider.
- Idea: Create parameters for monthly fluctuations in RUBs charges.
- Cost of submetering for water is prohibitive. Landlords have called contractors and they are either not willing to bid because they often to not get the work because the cost is so high.
- A landlord stated when the tenants have to pay for the water bill, they are more likely to inform the landlord of a leak so they problem gets resolved much faster, he has had tenants use a vice-grip with a leaky faucet and paid additional water and repair costs from the neglect.

Ellis Act

- One for one seemed common practice – what do other cities do?

Source of Income

- A landlord mentioned that he is working with a Section 8 tenant and it has taken 2 to 3 weeks for a deposit and rent, if the program was faster with onboarding he would consider more often.
- Another landlord mentioned he does not have the time to accommodate the additional work required for Section 8 tenants and felt that the word "discriminating" should not be used regarding landlords screening process.
- Participant mentioned if more landlords knew that they could get closer to market rate for their ARO rental units, they might be more willing to take on the programs.

2-12-18 Public Comments Summary

Tenant Protection Ordinance

- If there is 1 issue, having a gun, would landlord and other tenant want that person with the conviction still living in the unit? Would this be a material lease violation?
- Material violation - what is an example or designate an issue that is material? Example, starting a fire in a backyard. Does lease must specify "criminal activity" or "fire" in the lease?
- If someone is arrested for domestic violence, can a landlord serve a notice?
- What is the City of San Jose's position on criminal activity? Tolerant or zero? 3 day notice? not required and go directly to evict?
- The warning is significant, should a 3 day notice still be allowed or evict right after the 1 instance?
- Someone (for example, son or daughter) can be evicted for a conviction and automatically move in with his mom without approval from the landlord, they/tenant are protected. The roommate clause allows for harboring of criminals.
- Landlord should be able to do a review to be aware of a conviction and maximum number of tenants move in? Landlords need some type of help with this issue/check.

Apartment Rent Ordinance

- Some landlord also do their own RUBs, not only just 3rd parties doing to calculations.
- There should be a RUBS allowed option for consideration by the City Council.
- Will electricity be considered a part of RUBS - all utilities should be considered?
- HUD utility rates, how do they factor or calculate? HUD rates should be removed because nobody can determine their factor.
- What about an alternative for a landlord to charge an additional 1% in rent if their building is master metered, similar to LA?
- Landlord feels is RUBS is not allowed, an angry tenant will leave the water running so landlord must pay bill and lose money, no conservation.
- If you remove storage and lose rent, will the rent ever be increased or will it be lost income going forward?

Ellis Act

- Will there be a separate outreach for Ellis Act with developers? This issue is less significant for ARO property owners.
- How is relocation defined or determined? Chart available for calculation per number of bedrooms, how was the cost determined?
- Regarding which units are covered by the Ellis Act, why 1979 when 1985 is when Ellis went into effect?

Source of Income

- What is the Housing Department's position on Source of Income, is it neutral or direction to create an Ordinance? Housing will be bringing a framework to Council and wait for direction.
- Given a mandate, the Housing Department's position does not appear neutral.
- What is the reason for the source of income policy issue? City Council asked Housing to explore.
- Source of Income issue is not Section 8 voucher holders, instead the deterrence for landlords is the logistics, time, and cost for using Section 8. Housing is painting the wrong picture about landlords.
- A landlord indicated never used Section 8 because the heard the program was a zoo and has created more problems, does not believe in program.

2-12-18 Public Comments Summary

- Had a Section 8 tenant, has lost thousands of dollars, many lawsuits, and they know how to gain the system.

General questions

- What is the definition of Affordable Housing? Is there special funding for developers if they build Affordable Housing?
- Is there a special property tax relief for Affordable Housing?
- Public Notice is done through ARO; would landlords be notified for specifically for Ellis Outreach?
- Participant feels their input falls on deaf ears, rules appear to be protecting tenants, not landlords.
- Landlords do not want to file a Capital Improvement petition, does not want to ask Housing an allowance to increase rents.

2-22-18 Tenant Input Public Comments Meeting

Ellis Act

- Not enough resources available for a tenants to move or relocated while development of property.
- Better option is for lower rents for low income tenants.
- Tenant moved to affordable housing, not able to find affordable housing with good paying job.
- Tenant in affordable housing got an increase of $250 this year, should not be considered affordable.
- It should be very expensive to evict tenants living in ARO units.