



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jacky Morales-Ferrand
Christopher Burton

SUBJECT: SEE BELOW

DATE: May 26, 2023

Approved

Date: 5/29/2023

SUBJECT: EXPEDITING THE AFFORDABLE HOUSING PRODUCTION PIPELINE

BACKGROUND

This Manager's Budget Addendum responds to a request from Councilmember Batra that was included with City Council's approval of the Mayor's March Budget Message for Fiscal Year 2023-2024 to provide a cost estimate to implement the following services enhancements:

1. Identify and purchase properties within San José suitable for permanent affordable housing using funds that would have otherwise been included in Notices of Funding Availability; and
2. Perform initial pre-planning and development work to allow for a process whereby affordable housing developers could respond to a City-issued Request for Proposals to own, build and operate Affordable Multifamily Buildings for properties for which acquisition of real estate, basic planning (max # of units, # of stories etc.), zoning, community clearances, and City financing availability have been completed.

Councilmember Batra clarified at the City Council meeting that the purpose of this item is to explore alternatives to potentially expedite the development of affordable housing.

ANALYSIS

Staff has evaluated the proposal to have the City acquire a potential site suitable for affordable housing, complete initial planning, and lease the site back to a qualified affordable housing developer. While this model may save the developer time, the City is likely to incur greater costs and the overall development process timeline would increase.

Site Identification – The first step in the development process is site identification. The City currently identifies sites that are suitable and available for residential development. These sites are published on the City website on an application called the [San Jose Housing Site Explorer](#). The interactive website acts as a tool to determine the capacity of the site, planning and building permits needed, if the site is included in an Urban Village of Urban Growth Area, and the site's

qualification for the 1.5-acre rule in the General Plan (which allows affordable housing developers to build on underutilized commercial sites).

Land Acquisition – Land acquisition requires specific steps that must be followed to purchase a site. The Housing Department works closely with the Real Estate Division in the Office of Economic Development and Cultural Affairs to complete due diligence prior to closing on the purchase of the site. Staff coordinates with consultants to complete an appraisal, initial environmental review, relocation analysis, insurance coverage, and other items as necessary. Prior to purchase, staff must obtain City Council approval to acquire the site. If the City wanted to complete a basic study to determine the potential layout of a building on the site, staff would need to hire consultants to complete a feasibility analysis. The Housing Department does not have in-house staff with development expertise to complete this work. Additionally, the City will need to spend funds on carrying costs while it holds the property including utilities, weed abatement, and security.

An alternative to the City purchasing land would be for the City to fund a land acquisition and predevelopment loan program under a Community Development Financial Institution. Obtaining funding for these expenses is limited and expensive. Because these funds are used before a project receives its entitlements and construction funding, traditional lenders consider these high-risk loans and therefore they carry a higher interest rate. The County of Santa Clara created a similar fund for their Measure A projects which has facilitated and expanded their affordable housing projects. The County set aside \$12 million to establish its loan acquisition and predevelopment program with the Housing Trust of Silicon Valley. The Fiscal Year 2021-2022 Measure E funding plan set aside \$10 million for a land acquisition program. Due to competing priorities, the Housing Department did not have time to establish the program. These funds are now included in the reallocation of Measure E funding towards homeless solutions, per the City Council-approved Mayor's March Budget Message for Fiscal Year 2023-2024.

Developer Selection – In order to maintain compliance with state and local requirements, the Housing Department must hold a competitive process to select developers for the disposition of acquired sites. A Request for Proposals, or other City solicitation, would be released requiring multiple developers to spend time and money completing the application. A panel would review and score the application and staff would return for a second time to the City Council to obtain approval to enter into an agreement with the developer. Once the developer was ready to move forward with financing, the Housing Department would have to return for a third time to the City Council to obtain a funding commitment.

Entitlements – Changes to state law reduced the development review process for affordable housing developments. Senate Bill 35 (SB35) and Assembly Bill 2162 (AB2162) created a streamlined ministerial approval process that reduces local discretion and environmental review. SB 35 applies to cities that are not meeting their Regional Housing Need Allocation (RHNA) goal for the construction of housing for households below 80% Area Median Income (AMI). Currently, San José is not meeting the RHNA goal for affordable housing at 80% AMI. Therefore, at this time, projects providing at least 50% on-site affordable units are eligible for streamlining. AB 2162 allows streamlining for 100% affordable projects with at least 25% (or 12

units, whichever is greater) set aside for supportive housing. The timeline for the application for review under SB 35 is 90 calendar days for projects with up to 150 units, and 180 calendar days for projects over 150 units. Under AB 2162, the time limit for application review is 60 days for projects with up to 50 units, and 120 days for those over 50 units. Projects benefit from the ministerial process by having shorter timelines and may experience cost savings by avoiding having to navigate the discretionary entitlement process. In addition, the City has two affordable housing planners that assist developers in making it through the development review process and through the permitting process. The majority of the affordable housing developments are taking advantage of streamlining and the coordination that the City offers.

Additionally, when seeking entitlements, the development must be designed with details regarding the structure. Staff does not have the skills or capacity to complete this work, so consultants would need to be hired to manage this process. When the City brings development projects forward, the proposal is considered a public project and is subject to state and local laws that may not otherwise apply when a developer is seeking entitlements.

Proposed Opportunity for Additional Streamlining

As part of the Housing Element Update, staff is exploring an approach to develop a ministerial approval process for market-rate developments that build on-site affordable units that exceed their onsite Inclusionary Housing affordable housing requirement. This ministerial approval process could mirror what is already allowed under state law; it would potentially save both time and money for market-rate developers and facilitate both the production of market and affordable housing in a mixed-income community. Once this approach is finalized and approved by the City Council under the Housing Element, staff would begin the process in 2024.

CONCLUSION

Though its intent is to identify ways to potentially accelerate affordable housing development, the proposed model would shift the burden, cost, and risk to the City. The model adds more steps to the overall process, effectively lengthening the time needed to complete the entitlement process and requires the City to hire either staff with the required development expertise or procure consultants. There is also the added risk that the development may not go forward and the City would have to land bank the site until a developer could be identified. And finally, there is a healthy pipeline of affordable developments that are already working their way through the entitlement process. Intervening now would only create more competition for the scarce gap funding and state tax credits needed to finance affordable developments.

The City should continue to find ways to facilitate the development process. However, there are market rate barriers to development that are unrelated to the entitlement process. High construction and land costs, and the limited availability of both local gap financing and the state tax credit program have impacted the development of affordable housing in San José. The upcoming study session on the cost of construction of affordable housing scheduled in the fall will examine these barriers and offer potential solutions.

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COORDINATION

This memorandum was coordinated with the City Attorney's Office, the Office of Economic Development and Cultural Affairs, and the City Manager's Budget Office.

/s/

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/s/

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