

Inclusionary Housing Ordinance
KT Urban Memorandum
Agenda Item 8.2
February 23, 2021

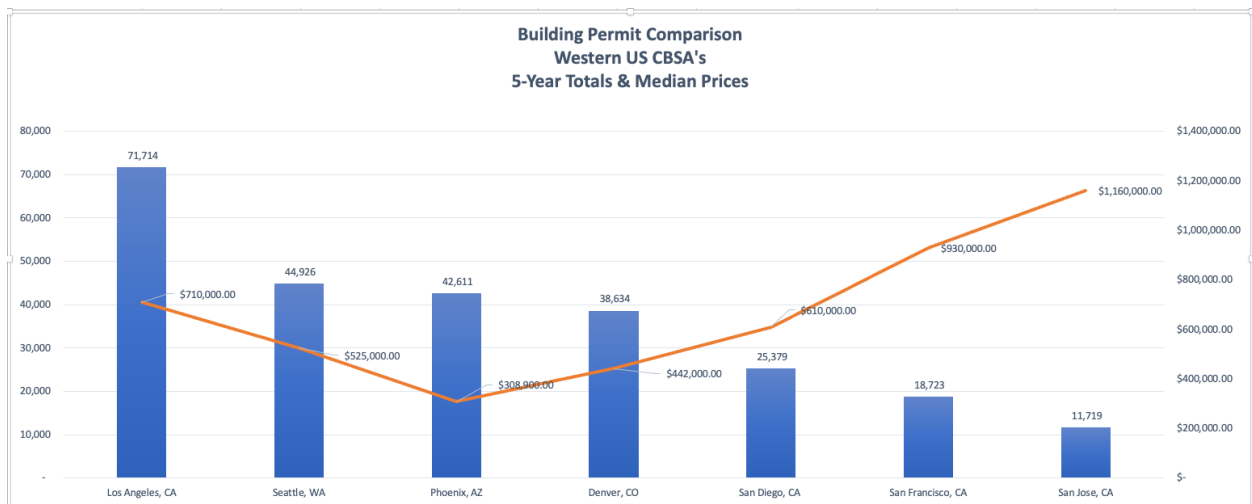
Introduction

We applaud the City’s efforts to modify the Inclusionary Housing Ordinance (“IHO”) especially the change from per unit to per square foot calculations. However, the modifications will result in some projects incurring higher fees without understanding the consequences of these changes. The feasibility of the IHO and its impact on housing production, both market rate and affordable, is tantamount to this discussion. Furthermore, the Council should consider the pipeline of approved projects and exempt them from additional fee increases especially during the COVID pandemic. We also hope that the Council will seek to offset the cost of the IHO with incentives such as increasing allowable heights and densities as well as reductions in required commercial space.

When evaluating the proposed changes to the Inclusionary Housing Ordinance, we hope that you ask one simple question: how will the proposed changes increase the housing supply for both market rate and affordable housing in San Jose?

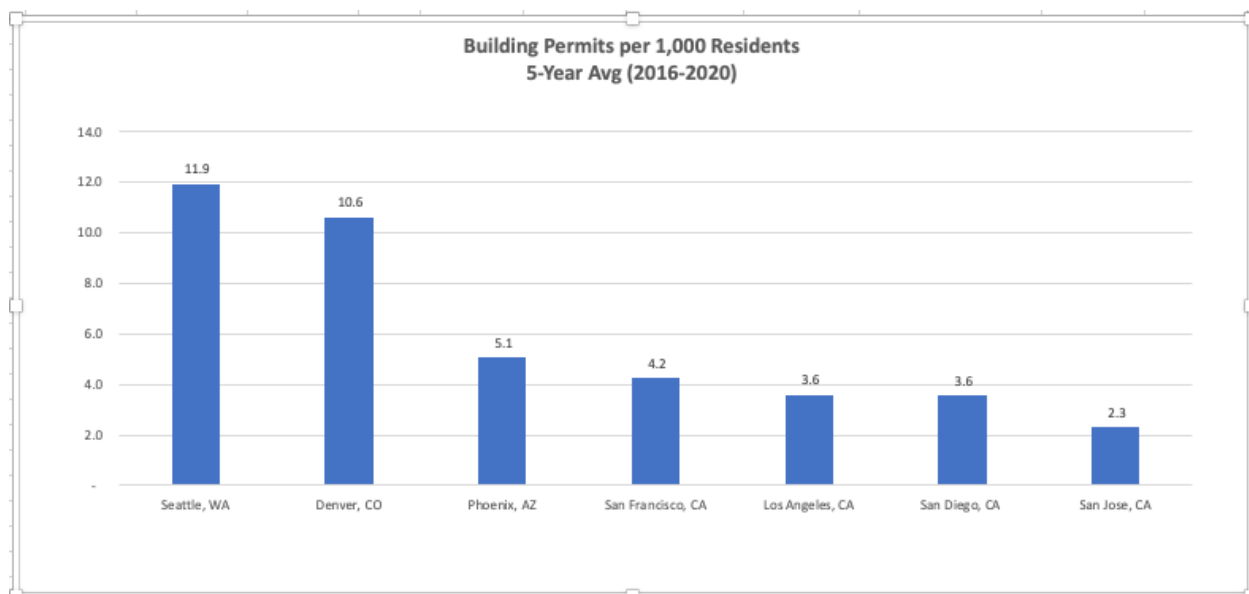
Background

Over the last five- and ten-year periods respectively, San Jose produced the lowest amount of building permits among the major Western US markets contributing to some of the highest median home price in the US. The City of San Jose’s ability to produce housing is clearly broken and the costs are too high. Instead of continuing to tweak well-intended, but failed, policies that restrict our supply, we must seek out a new direction if we are to meet our goals of reducing the housing burden for many of our families.



The City adopted an Inclusionary Housing Ordinance in January 2010. The Inclusionary Housing Ordinance generally taxes new home construction in the hope of producing more subsidized housing for eligible buyers and renters. While it's difficult to find studies that evaluate the impact of inclusionary housing policies on supply, economic theory suggests that new taxes on housing would result in less supply and higher prices. In other words, it stands to reason that the City's fee structure is inhibiting new construction projects from reaching acceptable return metrics in order to attract capital in the marketplace.

The building data supports the assertion as the City's housing production continues to fall despite the region's record economic growth. If we look at the City of San Jose's building activity from 1980 to 2009, the City produced an average of 3,027 building permits over this thirty-year period. Since the adoption of the inclusionary housing ordinance in 2010, the City's production fell 13% to an average of 2,643 units over the ten-year period from 2011-2020 and by an additional 300 units per year (2,344 average) from 2016-2020.



The inclusionary housing fee, park fee and construction taxes in San Jose are the primary drivers of impact fees in the City of San Jose constituting approximately 60-80% of the fee burden. According to the Turner Center for Housing Innovation at UC Berkeley in *It All Adds Up: The Cost of Housing Development Fees in Seven California Cities* in March 2018, the cities of San Diego and Los Angeles have significantly lower impact fee burdens than San Jose and have produced substantially more supply. The median home prices are also significantly lower.

The City of Seattle which is most similar to San Jose in terms of economic base, geographical constraints, and demographics produced nearly 3.8x the number of building permits from 2016-2020. Seattle doesn't have impact fees and the affordable housing fee is offset by an increase in building heights in the downtown core where most of the volume has been produced. Seattle

also offers MFTE, the Multifamily Tax Exemption, which allows new developments to be tax exempt (not land) for a period of time (typically 12 years).

In September of 2017, Mayor Liccardo wrote a memo entitled *Responding to the Housing Crisis*. This bold memo called upon the City of San Jose to build 25,000 homes and 10,000 affordable units by 2022. The Mayor states that the inclusionary housing ordinance could generate 3,750 affordable units by hitting the 25,000 goal. Since the memo, the City has fallen well short of the Mayor's goal producing only 6,550 building permits (26%) from 2018-2020. The peak number of permits issued was 2,836 in 2018—far short of the 5,000 permits need annually to meet the goal.

In order to stimulate increased residential construction, the City must move away from taxing housing and find alternative funding sources for subsidizing affordable housing. The Mayor's memo rightly calls out *Aligning Fees to Encourage Housing Production* as a primary driver of increasing supply. We agree and applaud the City's efforts to modify the inclusionary and park fees such that the fee is based on square feet rather than units. However, the overall fee burden has not decreased and was initially set at a level that discouraged new housing. Furthermore, once enacted, a fee has a natural tendency to continue to rise despite the impacts on housing production. We are seeing this tendency come to life in the Housing Department's recent modifications to the Inclusionary Housing Ordinance in real time.

The City Council must balance priorities especially when the goal of City departments may not align with the overall health and general welfare of the City. For example, the Park Department's goal is to build more parks and the Housing Department's goal is to finance subsidized housing, not promote housing production. Recognizing the inherent conflict here is critical to finding equitable solutions. We would hope that the Economic Development department would serve as an arbiter here, but in many cases, ED has remained silent and supported policies which do not promote housing and serve to drive our human capital out of the region in search of more affordable housing.

The City continues to discuss the concept of a development fee framework or universal development fee. In concept, a universal fee would be easy to calculate and provide certainty when developers are evaluating potential projects. However, a universal fee or development fee framework will only help meet the City and the Mayor's goal if fee levels are reduced significantly below the levels imposed today on new housing construction.

In 2020, the State made significant progress in stimulating housing production. Unfortunately, many believe that the legislature fell far short in its efforts to address the housing crisis especially with the defeat of SB 50. More work needs to be done and the City needs to continue to advocate for change in Sacramento. We believe that CEQA reform, local zoning reform and increased tax increment financing for affordable housing are critical to our collective efforts. For example, urban infill developments should be exempt from CEQA and those who are victims of frivolous CEQA lawsuits should be provided recourse under the law. Meanwhile, the City must act and tear down the barriers that it has created to producing housing at all income levels.

Conclusion

State Senator Scott Weiner is often quoted as saying that the “no growth trope” is that you can solve the housing crisis by building subsidized housing alone. It’s clear that only robust market-rate housing production can alleviate our housing crisis and help assist the most vulnerable in our community.

“While affordable housing programs are vitally important to the households they assist, these programs help only a small fraction of the Californians that are struggling to cope with the state’s high housing costs. The majority of low-income households receive little or no assistance and spend more than half of their income on housing.”

In February 2016, the CA Legislative Analyst’s Office, a non-partisan advisory office, released the report entitled *Perspectives on Helping Low-Income Californians Afford Housing*. The report was a follow up to its causes and consequences of the California housing shortage published in 2015. In short, the only way to stem displacement is to build more housing in supply constrained markets like San Jose. Furthermore, the report seeks to address the concern that new housing supply does not increase the supply of more affordable housing. The report concludes that new construction has the overall effect of keeping rents low for existing tenants and adds to the supply of affordable housing by slowing rent growth in older neighborhoods.

“When new construction is abundant, middle-income households looking to upgrade the quality of their housing often move from older, more affordable housing to new housing. As these middle-income households move out of older housing it becomes available for lower-income households. This is less likely to occur in communities where new housing construction is limited.”