



Memorandum

To: Rules and Open Government Committee
From: Councilmember Pierluigi Oliverio
Councilmember Pete Constant
Subject: Request for Additional Information Regarding Citywide Inclusionary Policy
Date: October 24, 2008

Approved: _____

RECOMMENDATION

Based on the conversation at the October 15, 2008 Rules and Open Government Committee it is clear that the public outreach has not captured numerous concerns regarding the potential negative impacts of a citywide inclusionary policy. San José Housing Director, Leslie Krutko, stated this sentiment clearly in the committee meeting when she said that in her meetings with stakeholders she has told them, "It is not very constructive for us to talk about why this is a bad idea, because we have been asked to come back with a policy." This lack of information will prevent the City Council from being able to make an informed decision on any proposed policy and is wholly inconsistent with City Council Policy 6-30: *Public Outreach for Pending Land Use and Development Proposals*. Furthermore, in order for the City Council to make an informed decision it is clear that a thorough comparative analysis is necessary. As a result, we recommend that the Rules and Open Government Committee:

1. Direct the city staff to return to the Rules and Open Government Committee with an amended status update on the Citywide Inclusionary Policy that includes all of the input received during public outreach. If concerns were not recorded, then staff is directed to redo the public outreach in its entirety.
2. Direct the city staff to return to the Rules and Open Government Committee with a status update on the Citywide Inclusionary Policy that includes an analysis of the economic impacts that other Cities have experienced as a result of implementing inclusionary zoning ordinances.
3. Direct the city staff to return to the Rules and Open Government Committee with a status update on the Citywide Inclusionary Policy that includes an analysis and comparison of the potential affordable housing unit production compared to the production San José has achieved over the past decade through existing incentive programs.
4. Direct the city staff to return to the Rules and Open Government Committee with a status update on the Citywide Inclusionary Policy that includes a comparative analysis of alternatives to a Citywide Inclusionary Policy, which have been previously used in San José and other areas to increase the supply of affordable housing.
5. Direct the city staff to refer this information to the Neighborhoods Commission for input. A citywide inclusionary policy could dramatically change the character of San José's neighborhoods and therefore rightly falls within the purview of the Neighborhoods Commission.

PURPOSE

There are three purposes for our memo: 1). Ensure that public outreach is consistent with City Council Policy 6-30: *Public Outreach for Pending Land Use and Development Proposals*. Staff must make every effort to report stakeholder input in a comprehensive manner, rather than filtering it to match what they feel the Council wants to hear; 2). Ensure that the City Council is able to make an informed decision on a citywide inclusionary policy that includes a comprehensive comparative analysis; 3). Ensure that a policy that might have significant impact on neighborhoods is fully vetted by the Neighborhoods Commission.

BACKGROUND

On June 17, 2008, the City Council directed the Housing Department to bring back a citywide Inclusionary Housing proposal for council discussion. The City Council's direction included significant public outreach. It has recently come to light that city staff, perhaps inadvertently, skewed the results of this outreach by discouraging the communication of concerns.

For example, many attendees referenced the fact that the City of San José is experiencing a severe budget deficit and the United States is encountering one of the worst economic and mortgage crisis' our county has experienced since the Depression. Many stakeholders stated that now is not the time for the City to expend its resources on a citywide affordable housing program. We are concerned that this relevant information may not be considered "constructive" and therefore will not be communicated to the City Council.

The Housing Department is looking at Inclusionary Housing as the only option, and even goes so far as using market rate developers as the sole entity for funding to implement a city-wide affordable housing proposal. Developers should be held accountable for fees that provide amenities and infrastructure for San José to mitigate the impacts of development. Market-rate developers currently pay park fees, taxes and other fees that fund core city services. However, we do not agree that the residents of San José want a city-wide Inclusionary Housing policy. Furthermore, it is unlikely that market-rate developers will be able to afford to shoulder the burden of funding this experiment, while simultaneously paying Parkland Dedication Ordinance (PDO) or Park Impact Ordinance (PIO) fees and other fees that provide infrastructure for the City. Currently, affordable housing projects are exempt from these fees.

San José uses the Association of Bay Area Governments (ABAG) as its primary reference when planning for San José's future affordable housing needs, even though San José is not legally obligated to comply with ABAG's recommendations. San José has long been the Bay Area leader in providing affordable housing. In fact, through our current incentive programs and existing inclusionary requirements, San José has produced over 7,000 affordable units in the past 10 years. San José has converted industrial and commercial land to accommodate market rate and affordable housing demands. Projects that were once planned as market rate are now being converted to affordable units in order to respond to market conditions.

Although we acknowledge the Housing Department's goal and due diligence in wanting to provide housing to all people, we are concerned that the Housing Department did not bring back various affordable housing options for council consideration and/or adoption instead of only the Inclusionary Housing concept. It is clear that the Housing Department is in favor of Inclusionary Housing, therefore, it appears the council has not received objective information regarding all possible citywide options to develop a policy for the City except for the Inclusionary Housing model.

Inclusionary Housing is an ideological issue that warrants a realistic, thoughtful and pragmatic discussion. As elected leaders, we strive to make sure that government can and will work for all people; not just a few. We want to create policies that help others, however, in doing so, we must acknowledge that local government cannot, does not, and should not try to be all things to all people. In our opinion, Inclusionary Housing is an attempt for local government to be all things to all people. Inclusionary Housing does not solve the problem of home ownership, nor does it provide investment opportunities for those who choose to "purchase" or live in

these units. Inclusionary Housing is not the only option to provide for a citywide housing program. The City of San José should investigate all options fairly and objectively before adopting a citywide policy.

Inclusionary Housing programs have been adopted in other cities, however, the level of success is severely questionable and some of these cities did not nor do not have a way to measure (with quantitative data) whether these inclusionary programs have been successful. To be frank, for every argument that says Inclusionary Housing is working, there is another group saying it isn't. What does this controversy tell San José? Well, to us, it says that we may need to a better approach in creating vibrant housing opportunities other than Inclusionary Housing.

What is Inclusionary Zoning?

Inclusionary Zoning and/or Inclusionary Housing requires developers to make a percentage of housing units in new residential developments available to low and moderate-income households. These new "affordable units" must retain below market price controls for a specified period of time. As a result, developers may receive non-monetary compensation in the form of density bonuses, zoning variances and/or expedited permits that reduce construction costs.

The thought is that by linking Inclusionary Housing to private market development, the City of San José will somehow expand the supply of affordable housing in areas where new developments are built. However, this may not be the case and data from other cities with Inclusionary Housing do not suggest that the goals set forth with their Inclusionary Housing Policy's were met.

Does San José need Inclusionary Housing?

No, in our opinion, San José does not need a citywide Inclusionary Housing program nor does it appear that Inclusionary Housing is something that the majority of residents in San José want. It is important to note that we are talking about "housing units" not home ownership. We fear that in our desire to "provide housing" we are creating a façade—something that looks good on the outside but has little to offer in the inside. We have not adequately addressed the question of for sale and rental units and how these equate to the proposed Inclusionary concept.

This thought also mirrors our concern about creating subsidizes. San José seems to want to give and not receive anything in return when it comes to city mandated subsidizes. Unfortunately, the City of San José seems to favor grants rather than loans which equates to the City giving money away without any return on its dollar. In these economic times, San José should be doing all it can to generate revenue not creating more subsidizes. San José is creating short term band-aid approaches instead of long term solutions. Is this what the residents of San José want or need?

If the city council feels so strongly about providing Inclusionary Housing, then perhaps the voters should vote on the subject? The current proposal of mandated citywide Inclusionary Housing (if an alternative is not adopted) policy will affect property values throughout San José. As a result, Inclusionary Housing most likely will only create other problems down the road for San José residents.

How will San José measure the success of an Inclusionary Housing program?

San José has yet to develop its own measurement of success for housing within its boundaries. When will San José have "enough" affordable units to meet the needs of everyone who qualifies for Inclusionary Housing? How can we adequately know how much more we need if information regarding how much housing we have built in the past is not readily available? Will San José build housing on every piece of barren land? How will San José measure and define for sale units compared with rental units? What are the quantitative measurements?

City staff from the Planning and Housing Departments are checking to see how much market rate and affordable housing San José has produced within the past ten years. Unfortunately, this information is not readily available. In order to know how much Housing San José needs and/or should be responsible for, it is important

that we know how much has been built and entitled to date. As mentioned earlier, San José is using ABAG's numbers which are numbers that are imposed upon us.

What is Affordable Housing?

According to the National Low Income Housing Coalition, in the San José area, the fair market rent for a two-bedroom apartment is \$1,284 per month. Thus, in order to afford this home, one must earn at least \$51,360 annually. In order to afford this home, a worker who earns the California defined minimum wage of \$8.00, must work at least 123 hours a week. The Non-Profit Housing Association of Northern California found that in Santa Clara County, 39% of local jobs pay less than \$30,000 per year and "four out of the ten fastest growing jobs pay less than \$21,000 per year." Moreover, economists and countless major U.S. cities have agreed, that for Housing to be "affordable" then it must represent no more than 30% of a household's annual income. What equates to "affordable" can be subjective and fluid. As a result, the definition of affordable housing can and most likely will change given our economic climate.

Does San José need Affordable Housing?

Yes. San José needs affordable housing programs. In fact, San José has done, and continues to do, a very good job in providing affordable housing in San José. The Housing Department has many programs that benefit people who wish to rent and/or purchase a home.

San José began its affordable housing program in 1989 and is currently providing housing units to very low and low income levels. The Housing Department works with many affordable housing developers and provides incentives to them to develop affordable Housing in San José.

San José is already considered the "bedroom community" of the South Bay

Providing for San José's future housing demand is important, however San José's housing/jobs balance is already tipped in favor of housing. It is incumbent upon the City Council encourage job growth and find sustaining revenue sources to fund existing city service demands.

The results of mandatory price controls: Los Angeles County, CA & Orange County, CA

Let's take LA County as an example for Inclusionary Housing. LA County produced an average of 34 units per year although their estimated need was 1,600 units per year. It appears that higher building costs with Inclusionary Housing is largely responsible for reducing the supply of new homes by 17,296, not to mention the mortgage crisis.

Voluntary Incentives over Mandates: Austin, TX

Austin, Texas took a different approach and instead of mandating Inclusionary Housing encouraged voluntary incentives instead of instituting restrictions. Voluntary incentives better serve lower-income community members, middle-income homeowners, developers, and municipal governments. In fact, the City of Austin instituted a plan in 2000 that used fee waivers, expedited permit review times, and neighborhood advocacy as incentives to encourage developers to designate a certain percentage of their new developments as affordable Housing. In five years, more than 26,000 certified affordable units were built as part of this popular initiative.

Two tiered system is not good for San José

The thought of price controls fly in the face of traditional economics, the reality of Inclusionary Housing presents an entirely different burden. Inclusionary Housing, as we see it, does not foster inclusion at all, but rather it creates discriminatory segregation. By creating two separate housing markets-the price controlled (below market homes) and the non-price-controlled, we inevitably create legislative double standards. We should encourage interaction between the different housing markets, not separate rules. While Inclusionary Housing aims to create affordable housing and be synonymous with equality, it often rarely meets these high held expectations. With dozens of ordinances and over three decades, California has certainly become familiar with the prospects of Inclusionary zoning. Unfortunately, the sheer number of cities adopting such ordinances shows nothing as a measure of success and is subjective, at the very least.

As expected, when housing price controls are set, production is not encouraged. As a member of the ABAG, San José alongside other neighboring cities, estimated that 133,195 affordable housing units (or 24,217 per year) would need to be created between 2001 and 2006. Yet, within all the decades that Inclusionary Housing has been implemented in the Bay Area, Inclusionary Housing has resulted in the production of only 6,836 affordable units, or 228 units per year. Moreover, an overall decrease in about 30% of new construction occurs after the mandates. In effect, on average only 14.7 units per year have been created due to an Inclusionary Zoning requirement. Thus, the program would have to be at least twenty times more effective each and every year to meet the Bay Area's affordable housing needs as currently suggested. This national housing problem only exists in areas where the supply of homes has not kept up with the increasing demand. Clearly there is a demand for affordable housing within San José, but Inclusionary Housing just cannot be relied upon to provide the needed results.

Inclusionary Housing hurts the community and lower income families it's supposed to help. By forcing developers to incur the burden of selling and creating homes at below market rates, we put developers between a rock and a hard place; developers could and may stop developing and leave for places that do not have Inclusionary Zoning requirements, or they can and will pass the loss of profit onto market rate consumers. Developers won't leave overnight, but over time we will feel the disintegration of market rate developments. In addition, by driving out developers, we can never hope to create the crucial number of affordable home ownership. As a result, lacking necessary incentives for developers, Inclusionary Housing will not create the low-income affordable housing units we would like to predict.

According to a UC Berkeley study, "until 1970, California prices had been in line with the national average of housing prices, but by 1980, California prices more than doubled the national average." Researchers found that fewer and fewer individuals were able to own homes not because of intrinsically high land prices, but by zoning and "growth control mechanisms" like Inclusionary Housing price setting. With a few exemptions, Inclusionary Zoning raises the price that buyers pay, decreases the profits that sellers receive, and ultimately leads to a decrease in homes built and owned, and higher median home prices in there area.

False Sense of Security

Inclusionary Housing is a false sense of security that creates a facade instead of actually creating affordable housing. Acting mostly as "feel-good" without the actual substance, these zoning practices do nothing to the curb the demand of housing. First, by setting price controls, few families end up getting below-market units. Although the amount may be greater than zero, in all cases the supply will never meet the demand. The question that comes to our minds is how one is to measure when will San José meets its goal and/or demand for this type of housing? Additionally, those that happen to get homes often have a similar false sense of security. Instead of the traditional view of real estate as an investment, these inclusionary homes are inevitably doomed to stay at below-market rates. By stripping low-income families of this significant means of investment you undoubtedly institute a veneer of security and cycle of dependency.

In the short term, Inclusionary Housing presents a political win-win illusion for developers, politicians, and low-income buyers. Developers perceive to "win" by building additional houses and apartments. Low-income buyers appear to "win" due to more available affordable housing. The unfortunate reality with this "winning" scenario is the invisible costs that choke off the rest of the housing market. These long-term problems are best illustrated in the Los Angeles and Orange Counties, where the higher costs of building in communities with Inclusionary Zoning reduced the supply of homes by over 17,000. Moreover, this situation is exacerbated because the price of controlled inclusionary homes are often 60% below the market rate with market rate homebuyers subsidizing low income homes by paying approximately \$33,000 to \$66,000 more per home.

Home Ownership

As we mentioned earlier, home ownership is part of the American Dream. Many people work hard, save money and then purchase a home after careful thought and consideration. In fact, many people buy one house in their lifetime; this "house" becomes their "home."

For many, the American Dream includes and/or is home ownership. More people own homes than rent. And, for most people, renting is usually a temporary situation to save money to purchase a home. It is important to provide opportunities for home ownership; at least for those who want to own a home.

Affordable housing is a nationwide problem; it is not isolated to San José. And, as we know, the entire country is going through a mortgage crisis. The City of San José needs to come to some sense of direction of how we want to create "housing units" with respect to home ownership. Do we want to create more renters than those who own homes? Are the City's goals to provide housing units and/or opportunities for people to invest after renting? Knowing that home ownership brings pride and high morale to many people, it behooves the City to ignore home ownership opportunities.

San José Needs To Define How Its Land Use Relates To Affordable Housing.

San José should explore the use of its own land for affordable housing opportunities. The City of San José has approximately 200 vacant parcels of land and 12 buildings that have been identified as being vacant and/or out of service, including the old City Hall on North First Street. With the cost of land being a barrier to development, the City could lease some of these parcels to a developer to build affordable units and streamline the development review process.

Therefore, the city provides affordable housing and receives revenue on an on-going basis. Along these same lines, is another opportunity that lends itself to consideration which is to ensure that various affordable housing opportunities are discussed in detail at the Envision Task Force meetings.

Another area worthy of investigation is seeking to increase the Redevelopment Agency's (RDA) housing set-aside. Redevelopment areas are already subject to affordable housing requirements. Redevelopment areas already cover nearly one third of the City. One way to produce more affordable units would be to increase the RDA's Housing set-aside from 20 to 30%. Other cities already do this. The impact would be a huge increase the City's tax exempt bonding capacity available for Housing.

By looking at how best to utilize City owned land, it would be in the City's best interest to adhere to state law which requires that incentives such as densities bonuses be used instead of fees to produce more affordable housing. Increased floor area ratios and increasing allowable building heights should also be taken into consideration so that builders can lower a project's land burden on the economics of the project.

Conclusion

This memo makes it clear that there are more questions than answers at this time as to whether a citywide inclusionary policy will best meet San José's future housing demands. A comprehensive review of alternatives is necessary to ensure that the City Council's consideration of this issue can be thorough and thoughtful. Imposing an Inclusionary Housing program throughout San José without looking at other viable affordable housing options is shortsighted. A citywide inclusionary policy will only hurt first time home buyers and others who will be burdened with the cost differential to support affordable housing.

We respect the good work that the Housing Department has done to provide affordable housing to those who may otherwise not have had a place to live. However, we are concerned that it appears the Housing Department may already be in favor of an Inclusionary Housing policy and as a result, that they have not provided an objective perspective in bringing forth information to the council regarding other options that could better serve the future housing needs of San José. We firmly believe that an Affordable Housing Task Force is warranted to bring about a fair and objective discussion so that all options can be vented publicly and objectively.

The Council has not had the privilege to be introduced to all citywide affordable housing programs that other cities have adopted. As a result, the council has currently positioned itself to choose whether or not they want a proposed Inclusionary Housing policy without any discussion or knowledge about other viable options. We

believe that staff did not present all options to council in an objective format and as a result the council has not had the opportunity to judge all options for a potential citywide housing proposal.

San José is suffering from a million dollar budget deficit and the Country is suffering one of the worst economic crises since the Depression. When constituents call our offices and ask for curb cuts, for their streets to be rid of massive pot-holes, requests for increased police protection, for more open space, more code enforcement, among a myriad of other basic needs, we are at a loss. How can we realistically expect to institute an Inclusionary Housing proposal when San José can't even provide basic infrastructure needs for the citizenry in San José?

We are concerned that Council has directed city staff to work on an Inclusionary Housing policy at time when the United States is suffering one of the worst economic crises in the United States' history. Instead, we should direct staff to generate as much revenue as possible to provide for our city's needs. We are concerned that too much of staffs time is being spent on this issue. Therefore, we strongly encourage that our colleagues support our recommendations in this memo.