COMMITTEE FOR
GREEN FOOTHILLS

June 6, 2006

Coyote Valley Specific Plan Task Force

**Re: Master Comment Letter on Draft Fiscal Analysis for Coyote Valley**

Dear Members of the CVSP Task Force:

Per the request by City staff for comments, the Committee for Green Foothills submits the following response that collect our previous concerns together, along with additional comments on the Draft Fiscal Analysis for Coyote Valley. We note that at the Technical Advisory Committee, staff and consultants appeared to support the CGF's suggestion that a Final Report include any revisions made over time and include a Comments and Responses Section similar to that done in a Final EIR. We hope this will still happen.

Additional comments follow:

**Consultant and staff response so far to CGF criticisms**: the most important CGF criticism of the Draft Analysis finds the Draft's assumption that housing costs can escalate 3% above inflation annually for 60 years, when household income increases much more slowly (less than 1% according to 1990s data), to be fatally flawed. The Draft concludes that a fiscal surplus will occur only because of this massive increase in property tax revenues, but that extent of increase will not happen. Instead, we believe it is not possible for housing costs to increase much in relation to household income, and that the Report should be revised accordingly.

The City's consultants had two responses so far: first, the 3% figure is a conservative match for increases over the last 30 years, so it is appropriate to use the same figure for the next 60 years; and second, while an ever-smaller percentage of families could afford to purchase homes over time, that smaller percentage could still push the market price ever higher.

We consider these responses to be inadequate. First, the past rate of price increases is irrelevant when encountering a new factor – in this case, the cost of housing increasing to more than 33% of median household income. We believe the past trend is unsustainable, and an unsustainable trend cannot be maintained forever. The Draft Report contains no analysis of whether that past trend can be sustained; it just assumes the trend can last.

Regarding whether a smaller percentage of potential buyers can maintain the constant real rate of increase in housing prices, it would be useful to view the incomes of people potentially interested in buying residences in Coyote as a normal distribution/bell curve, where the largest numbers of people have mid level incomes, while smaller numbers have high incomes or low incomes. See Figure A, attached, for illustrative purposes (y-axis is the number of people/buyers, x-axis is their income level (the numbers on the x-axis are arbitrary here)). The vertical line intersecting the apex of the curve could help delineate the current potential market of buyers. San Jose staff have stated the average household spends 33% of income on housing, and banks are unlikely to give mortgages to people where payments would be much larger than that percentage. At current ratios of housing to income, then, potential buyers are the sum of the area under the bell curve and to the right of the vertical line.

The effect of increasing housing prices faster than income is to shift the vertical line further to the right, decreasing the number of potential buyers. And because the largest numbers of buyers in the bell curve are at the lowest income levels still to the right of the existing vertical line, moving that vertical line even slightly to the right will result in a disproportionately large reduction of buyers. Finally, the Draft Report implies a very large rightward shift in that vertical line to the right. All the above indicates a large decrease in the number of potential buyers given the Draft Report assumptions, but the Draft still concludes that prices will increase at the same rate as it did with a larger pool of buyers.

What the Committee for Green Foothills cannot do is quantify these numbers, but the City's economic experts can. They should quantify how much the market will decrease given the relative changes in income and housing assumed in the Draft Report, and this would give a much better idea as to whether the housing prices can continue to climb at such an incremental rate.

**Related housing price comments:**

CVSP Task Force Member Craige Edgerton pointed out that Bay Area housing price increases don't occur in a vacuum. When Craige moved to this area, housing cost twice as much as it did in Texas, and now it costs five times as much. This is another example of an unsustainable trend that the Draft Report may be assuming will continue for 60 years. City consultants should examine what is expected to happen in the national housing market – if that market is not also expected to increase at 3% above inflation, there should be an acknowledgement of that in an "Unrealistic Assumptions" disclaimer to the Final Report.

Craige also pointed out that even if the 3% figure is accurate, it could result in wrong projections if done at the height of a bull market. See Figure B, attached, as an example of how this could happen using an upward trending sine wave. The x-axis is time, and the y-axis is housing prices (absolute numbers on the axes are irrelevant for these purposes). The sine wave represents the up and down swings of the market, while the overall upward linear trend represents a gradual increase over time, which the City argues will average out to 3% or better. Craige's point is that the 3% trend line could be drawn as tangent connecting the troughs of each curve, as a line bisecting the middle of all the curves, or as a tangent connecting the peaks of each curve. The most accurate starting point for extending the 3% trend line, in order to determine what future prices will be, would be from the middle. That does not appear to be what the Draft Report does, because the present position is much more likely to be at the peak, with an extended housing boom and what many are labeling a housing bubble in San Jose. To fix this, even if the City believes the 3% real rate is sustainable, it should begin its valuation with a partial correction (decrease in housing prices) factored in.

At a City Council Study Session, Councilmember Forrest Williams and City consultants referred to the Draft Report as intended to be conservative. To assist this goal of making conservative assumptions, we suggest the following: Assume at the beginning of the project that housing prices will drop the same extent as the greater of the last two drops in housing prices, which we understand to have occurred in the early 1990s and 1980s. Further assume that prices will for the next few years increase no faster than the worse-performing of the two subsequent recoveries, and increases will stay low as long as the slowest recovery took. Finally, assume prices will then increase no faster than the rate of median household income increase for the projected duration of the project. The Committee assumed household income would increase 1% based on 1990s data, but that may be overoptimistic, and City consultants may have better long-term data. The Final Report could include the above as an Alternative Assumptions that could be use for fiscal projections for the various scenarios.

**Other comments:**

The underestimate of affordable housing resulted in an overestimate of revenue. Twenty percent of 26,660 housing units in Coyote (the last number we've heard) is 5,312, not 5,000. This means that in all scenarios, 312 units were inaccurately counted as market rate units generating substantial property tax revenues, instead of affordable units generating little or no tax revenue. This error should be corrected.

Initial sale prices of affordable for-sale housing cannot be increased at the 3% real rate between the present and whenever the housing is constructed. When this question was asked at a Task Force meeting, consultants misunderstood it as a question about control of resale prices. The real issue is what value and property tax revenues the Draft Report assigns to affordable for-sale housing constructed say, 20 years from now. If it takes current affordable housing prices, and projects those prices to increase at a 3% real rate for 20 years, then any pretense that these future homes will actually be affordable is thrown out the window. Instead, the housing prices should be calculate based on expected income levels at the time of construction.

As mentioned in our earlier comments and reiterated here, none of the five scenarios included the most environmental of the action scenarios that we have discussed in the last year – retain the current triggers, and add some form of phased 2:1 jobs:housing concurrence thereafter. This would keep the advantage the current triggers have of prioritizing in-City development first, while avoiding an "open floodgates" problem with current triggers – after 5,000 jobs arrive, housing development can far outpace jobs development. We recommend that this scenario be added to the Final Report.

Also as mentioned earlier, all the concurrency scenarios have a "cannibalism" problem that has not been addressed in the Draft Report or anywhere else. The 2:1 ratios create a potential incentive whereby Coyote developers will offer cut-rate prices to business to relocate there away from central San Jose, because those developers will then make large amounts of money off the 2:1 right to construct housing that was created when the jobs moved. San Jose needs to address this problem in multiple contexts, but it could start in the Draft Report by reducing tax revenues to reflect cannibalized business tax revenues stolen away from central San Jose.[1]

This letter incorporates and requests responses to previous oral and written comments from the Committee for Green Foothills, especially the April 24th and May 8th letters and attachments, and the Excel spreadsheet distributed at the last Technical Advisory Committee. If City staff have trouble locating these items, we can provide copies.

Finally, there is one idea that could fix ALL the criticisms we have of the Draft Report. Following up on an idea from the Sierra Club, the Final Report should explore making the Community Financial Districts a permanent means to make up the budgetary shortfalls from Coyote Valley, as opposed to a temporary means used only in the project's initial years. If 20 years from now it turns out that Coyote is actually withdrawing more revenue than it brings in, the CFDs can rectify that situation with some kind of property assessment, maybe as a smoothed-average over several years to avoid dramatic assessment changes. Coyote Valley developers will presumably have no problem with this idea, as they are quite confident that after ten-plus years, Coyote will always deliver a fiscal surplus to the City. In that case, the CFD need never draw funds from Coyote Valley landowners. As it is, an uncertain level of risk remains that Coyote will not benefit the City. If Coyote Valley developers continue to assert that the risk is zero, then they should have no problem with it being transferred from the City to them.

Please contact us if you have any questions.

Sincerely,

Brian A. Schmidt
Legislative Advocate, Santa Clara County

[1] A partial fix of the cannibalism problem would be to use large concurrency increments – say after each 5,000 new jobs, 2,500 residences can be built. This would substantially reduce the incentive to relocate jobs from Central San Jose, and could be used appropriately for the environmental scenario outlined above.

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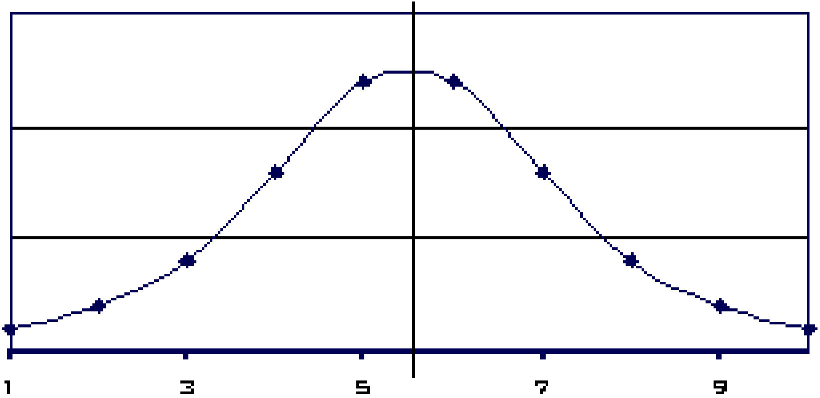

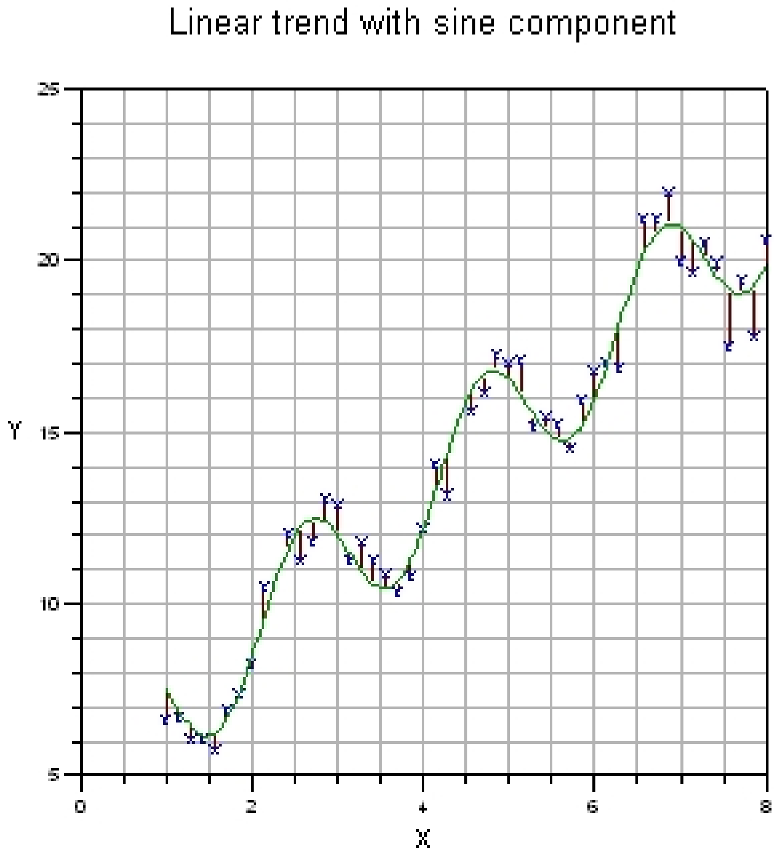
Linear trend with sine component
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