

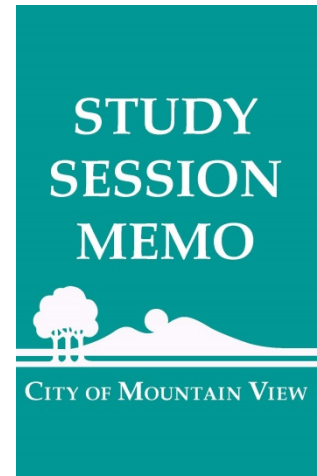
DATE: October 14, 2014

TO: Honorable Mayor and City Council

FROM: Linda Lauzze, Administrative and
Neighborhood Services Manager
Randal Tsuda, Community Development
Director

VIA: Daniel H. Rich, City Manager

TITLE: **Review of Affordable Housing Fees**



PURPOSE

The purpose of this Council Study Session is to review the City's affordable housing fees to determine if there is Council interest in increasing any of those fees. The Council requested this review at their May 13, 2014 Study Session on the update of the City's Housing Element. If the Council is interested in changing any of the fees, a Council public hearing would be scheduled for December 9, 2014 to consider and take action on the fee increase.

BACKGROUND

The City currently has three types of affordable housing fees:

1. Below-Market-Rate (BMR) In-Lieu fees on new ownership development, which are 3 percent of the contract sales price for each new home;
2. Rental Housing Impact fees on new apartment development, which is \$10.26 per habitable square foot; and
3. Housing Impact fees on new nonresidential development, which range from \$5.13 to \$10.26 per square foot for office/high-tech/industrial development and \$1.30 to \$2.60 for hotel/retail/commercial/entertainment development.¹

BMR fees were adopted in January 1999, followed by Housing Impact fees in January 2002. Rental Housing Impact fees were recently adopted in December 2012. At that

¹ Housing Impact fees for office/high-tech/industrial development are \$5.13 per square foot for the first 10,000 square feet and \$10.26 per square foot for building area greater than 10,000 square feet, and for hotel/retail/commercial/entertainment development, the fees are \$1.30 per square foot for the first 25,000 square feet and \$2.60 per square foot for building area over 25,000 square feet.

same December meeting, the Council also increased the Housing Impact Fee for office/high-tech/industrial development from \$3.71 to \$5.00 per square foot for the first 10,000 square feet and from \$7.43 to \$10.00 per square foot for building area over 10,000 square feet. Both the Rental Housing Impact Fee and the Housing Impact Fee are adjusted annually based on increases in the Consumer Price Index (CPI) for our area. The BMR In-Lieu Fee has never been increased, but naturally adjusts higher as the price of new ownership housing increases, since it is a percentage of the new home price.

Affordable housing fees help mitigate the impact of new development on the need for affordable housing in Mountain View. These affordable housing fees have put Mountain View in the fortunate position to continue producing affordable housing, while many other cities cannot due to the loss of redevelopment agency funds. During the past 10 years in Mountain View, affordable housing funds have produced 351 units for seniors, families, workers, and special-needs households. The City has contributed \$35 million to these projects that leveraged another \$61 million in outside funding sources. Two of these projects are currently under construction and will provide 49 units of workforce housing and 27 units for developmentally disabled adults. Two additional projects have submitted applications under the City's current Notice of Funding Availability (NOFA) and could produce a total of 132 apartments for lower-income families.

DISCUSSION

Nexus Studies

Nexus studies evaluate the impact of new development on the need for affordable housing and the fees required to mitigate that impact. For office and commercial development, a nexus study evaluates the number of jobs produced by new development, the percentage of those jobs that would be filled by lower-income workers, and the fees required to produce housing affordable for those lower-income workers. For ownership and rental housing development, the nexus study determines the goods and services needed by new residential households, the jobs created by that demand, the number of lower-income workers in those jobs, and the fees required to produce affordable housing for those lower-income workers.

A Nexus-Based Affordable Housing Fee Analysis was prepared by Economic and Planning Systems in September 2011 for the City's BMR ownership housing fee and the Rental Housing Impact Fee (Attachment 1). A nexus study was prepared in 2002 for the Housing Impact Fee when it was first adopted. Because this study was over 10 years old, a new Jobs Housing Nexus Study was prepared by Keyser Marston Associates in November 2012 when Council considered an increase to the fee (Attachment 2). These

studies determine the maximum fees supported by the analysis, but do not recommend a particular fee as this policy decision is within the Council’s purview. Impact fees are rarely set at the maximum levels. Both of these studies are recent, so new nexus studies are not required if the Council wants to increase fees at a level below the maximum fees determined by the studies.

Table 1 shows the current fees and the maximum supportable fees established in the nexus studies. As shown in this table, current fees are well below the maximum supportable fees in the nexus studies. BMR In-Lieu fees are based on 3 percent of the sales price of an ownership home and the maximum nexus study fees were also calculated on a percentage of sales price.

**Table 1. Current Fees and Maximum Supportable Fees
 (Per Square Foot)**

	BMR Fees	Housing Impact Fees (Office/Tech/ Industrial)	Housing Impact Fees (Com/Retail/ Ent./Hotel)	Rental Housing Impact Fees
Current Fees	3% of Sales Price	\$10.26 (first 10,000 sq. ft. – \$5.13)	\$2.60 (first 25,000 sq. ft. – \$1.30)	\$10.26
Maximum Supportable Fees	7.7% to 12.5% of Sales Price	\$59.31	\$243.61 (\$44.69 for hotels)	\$45.04 to \$70.85

Existing Fees Compared with Other Cities

BMR In-Lieu Fees

Each city tailors affordable housing fees to the needs, priorities, and economies of those communities. Eleven (11) of the 15 cities in Santa Clara County have inclusionary housing programs and many allow BMR In-Lieu fees under certain circumstances. Both the circumstances and the calculation of the fee vary substantially between cities as shown in Table 2.

Table 2. Comparison of BMR In-Lieu Fees

	Mountain View	Cupertino	Palo Alto	Sunnyvale
When Fees Are Allowed	Sales Prices >\$670,000 or Fractional Unit	Projects With 2-6 Units or Fractional Unit	On Site Units Not Feasible	Projects With 9-19 Units or Lots
Amount of Fees	3% of Sales Price for Each Unit	\$3.00 per square foot	7.5% to 12.5% of Sale Price for Each Unit	Difference Between Market-Rate Price and BMR Price ²

Housing Impact Fees

Only three other cities in Santa Clara County have Housing Impact fees on nonresidential/commercial development; Cupertino, Palo Alto, and Sunnyvale. A comparison of those cities with Mountain View’s fees is shown in Table 3. Palo Alto has the consistently highest fees, while Sunnyvale only charges impact fees to office/industrial projects exceeding a 0.35 floor area ratio (FAR).

Table 3. Comparison of Impact Fees (Per Square Foot)

	Mountain View	Cupertino	Palo Alto	Sunnyvale
Development Type				
Commercial/Retail	\$2.60 (first 25,000 sq. ft. – \$1.30)	\$6.00	\$19.31	N/A
Hotel	\$2.60 (first 25,000 sq. ft. – \$1.30)	\$6.00	\$19.31	N/A
Office/High-Tech/Industrial	\$10.26 (first 10,000 sq. ft. – \$5.13)	\$6.00	\$19.31	N/A
Only Planned Industrial Zones	N/A	\$3.00	N/A	N/A
Only Office/Industrial >0.35 FAR	N/A	N/A	N/A	\$9.08

² This fee would be calculated only on the required BMR units.

Rental Housing Impact Fees

Thus far, Mountain View is the only City in the County to adopt a Rental Housing Impact Fee, although the cities of Sunnyvale and San Jose have completed nexus studies and are holding outreach meetings on the nexus studies and possible fees. For a two-bedroom apartment with approximately 950 square feet, the maximum supportable fee in the San Jose nexus study is about \$28.00 per square foot, in the Sunnyvale nexus study it is \$40.00 per square foot, and in the 2012 Mountain View nexus study it is \$51.00 per square foot. A few cities within the region have adopted Rental Housing Impact fees and Table 4 shows a comparison of Mountain View's fees with these cities.

Table 4. Comparison of Rental Housing Impact Fees

	Mountain View	San Carlos³	Fremont	Walnut Creek
Fee Per Square Foot ⁴	\$10.26	\$26.70	\$19.50	\$15.00

Options for Increasing Housing Fees

BMR In-Lieu Fees

The BMR program was adopted almost 15 years ago and the in-lieu fee for ownership housing has not been changed since its adoption. The Council considered revising the program on August 23, 2005, but decided not to make any changes. The in-lieu fee amount is specified in the BMR Guidelines, rather than the BMR Ordinance, and can be amended through a Council Resolution.

The Guidelines allow developers to pay an in-lieu fee when the prices of homes in their proposed development exceed a certain threshold, which is now \$670,000. The in-lieu fee option was intended to avoid large gaps between BMR prices and market-rate prices, which can result in a substantial subsidy to a household purchasing a BMR unit. Almost all developers are allowed to pay an in-lieu fee due to the high price of new homes in Mountain View and choose to pay the fee rather than provide units.

BMR In-Lieu fees have been reasonably well accepted by ownership housing developers and the Council has rarely received complaints about the fees. However,

³ San Carlos fee per square foot is for projects with 10 units or more. Projects with less than 10 units have fees higher and lower.

⁴ Rental Housing Impact fees are based on habitable square footage and Housing Impact fees are based on net square footage.

housing advocates have been encouraging increases in the fee for many years. Other cities with higher fees have had lawsuits filed against their BMR programs, including Sunnyvale, Palo Alto, and San Jose. Two of those lawsuits are ongoing. Palo Alto's lawsuit is currently pending at the trial court level. The California Supreme Court will hear the challenge to San Jose's inclusionary housing ordinance. The case has been fully briefed, but a hearing date has not yet been set.

Recommendation: Staff is not recommending consideration of an increase in the BMR In-Lieu Fee at the December hearing. Changing the BMR In-Lieu Fee or policies about the fee would benefit from outreach meetings with developers and may require analysis of how increases would impact residential development activity. Developers have claimed that higher fees will increase home prices or be a disincentive to build ownership housing in Mountain View. In addition, the Supreme Court may not issue a decision on the lawsuit against San Jose for some time and this decision could significantly affect the City's BMR program. If the Council would like to consider increasing BMR fees, staff would recommend scheduling a Study Session and public hearing after the Supreme Court decision on the San Jose case.

Housing Impact Fees

The Housing Impact Fee was adopted about 12 years ago and fees on office/high-tech/industrial development were increased in 2012 when the Rental Housing Impact Fee was adopted. The Housing Impact Fee Ordinance specifies the fee be adjusted annually for increases in the CPI, but does not specify the base amount of the fee. Increases to the fee, in addition to automatic CPI adjustments, are adopted by Council resolution and would become effective 60 days after adoption.

In 2012, the Council increased the impact fees for office/high-tech/industrial development and decided not to increase the fees for commercial/retail/entertainment/hotel development. The fees became effective on February 9, 2013. The change resulted in a 35 percent increase in the fees: from \$3.71 to \$5.00 per net square feet for buildings up to 10,000 square feet and \$7.43 to \$10.00 per net square feet for building area more than 10,000 square feet. This increase was not controversial and few persons spoke against it at the Council hearing.

Table 5 shows several of the Housing Impact Fee options considered by Council in 2012. The table shows two approaches. One used the average fees of three neighboring cities as a guide to the fee levels for Mountain View. The average fee of \$11.68 per square foot for office uses was slightly higher than the \$10.00 per-square-foot fee adopted by Council, whereas the average fees for commercial-type development were much higher in these other cities.

The second methodology shown in Table 5 used the percentage of the adopted fees to the maximum supportable fee in the 2001 nexus study and applied these percentages to the new maximum supportable fees in the 2012 nexus study. This results in significantly higher impact fees for all types of development, but still well below the maximum supportable fees in the nexus study. This approach results in a fee of \$20.76 per square foot for office development. As a point of comparison, this is slightly higher than the \$19.31 per-square-foot fee levied by Palo Alto.

Table 5. Alternative Fee Methodologies

Existing Per-Square-Foot Housing Impact Fees	2012 Nexus Study Maximum Fee	Alternative Fee Methodologies	
		2014 Average Fees Other Cities	Percentage of Maximum Supportable Fees in 2012 Nexus Study ⁵
Office/High-Tech/Industrial \$10.26 (first 10,000 sq. ft. – \$5.13)	\$59.31	\$11.68	35%=\$20.76
Commercial/Retail/ Entertainment \$2.60 (first 25,000 sq. ft. – \$1.30)	\$243.61	\$12.66	13%=\$31.67
Hotel \$2.60 (first 25,000 sq. ft. – \$1.30)	\$44.69	\$12.66	14%=\$6.26

Recommendation: Revenues from Housing Impact fees slightly exceeded revenues from BMR In-Lieu fees for the first time last fiscal year. In the future, it is possible Housing Impact fees will produce the most revenues of the three affordable housing fees, given development in the pipeline. At least in the short term, increases to the Housing Impact fees may be most beneficial to achieving more affordable housing and a better jobs/housing balance. It will be difficult to accomplish a detailed analysis of the impact of increased fees before the December 9 meeting but the Council has substantial latitude when setting the housing fee levels, and has taken a moderate approach, given the maximum \$59.31 per-square-foot nexus study fee. Staff recommends that the Council consider increases to the Housing Impact fees for all

⁵ In 2002, the adopted fees as a percentage of the maximum supportable nexus fees were 35 percent for office/high-tech/industrial, 13 percent for commercial/retail/entertainment, and 14 percent for hotels.

nonresidential development, provide clear direction to staff, and set a public hearing for the December 9 Council meeting.

Rental Housing Impact Fees

The Rental Housing Impact Fee was adopted less than two years ago and was a difficult policy issue that took about 18 months of study and hearings. The fee was adopted by Council resolution and changes to the fee would be made by resolution. The final adopted \$10.00 per-habitable-square-foot fee was less than half the amount equivalent to the 10 percent BMR rental unit requirement in the City’s BMR Ordinance. The 10 percent BMR requirement can no longer be enforced due to the *Palmer* decision. State legislation to reinstate the rights of cities to require BMR rental units is on hold pending the Supreme Court Decision on San Jose’s inclusionary housing program. The ruling in that case may affect whether legislation will be reintroduced in the next session.

Since the fee was adopted, most apartment developers have offered to voluntarily provide BMR rental units in lieu of paying the fee as shown in Table 6. The number of units provided for each development has been equal to or less than 4.6 percent of the total units in the development, which is roughly equivalent to the \$10.00 per-habitable-square-foot fee.

Table 6. Market Rate Apartment Development Since Fee Adoption

Developer – Location	Number of Units	Rental Housing Fee	Number of BMR Units
1. Carmel Partners – San Antonio Center	330	\$2,715,250	0
2. Prometheus – 455 West Evelyn Avenue	203		7
3. Lennar Communities – 865 El Camino Real East	150		4
4. Prometheus – 1720 El Camino Real West	162		5
5. Prometheus – 1616 El Camino Real West	66		3
6. SummerHill Apartments – 2650 El Camino Real West	193		8
7. Urban Design Group – 1984 El Camino Real West	160		7
8. Prometheus – 100 Moffett Boulevard	184		8
Total	1,448		42

Recommendation: Most developers are providing affordable rental units as an alternative to paying the Rental Housing Impact Fee. The \$10.26 per-habitable-square-foot Rental Housing Impact Fee is roughly equivalent to providing 4.6 percent affordable units.⁶ An increase in the Rental Housing Impact Fee would create a higher unit equivalency and apartment developers would be expected to provide more affordable units in lieu of paying a higher Rental Housing Impact Fee. If the Council would like to consider a fee increase at the December meeting, there are two options that were discussed in the December 11, 2012 Council Report (Attachment 3) that could be considered:

- A \$14.30 per-habitable-square-foot fee that is roughly equivalent to a fee based on 3 percent of the appraised value of an apartment development, which is similar to the current BMR In-Lieu Fee of 3 percent of sale price for ownership housing; and
- A \$21.94 per-habitable-square-foot fee was recommended when the Rental Housing Impact Fee was adopted in 2012 and is similar to the housing fees charged for ownership housing.

Council direction on whether or not to bring back an increase in the fee on December 9 is sought.

Housing Funds Balances and NOFA Projects

On October 29, 2013, the Council reserved a total of \$15.5 million in housing funds for new NOFA projects, with \$2.9 million of this total reserved in an opportunity fund for outstanding projects. The available housing fund balance as of September 2014 is now \$22.8 million. Of this balance, \$15.5 million is still reserved for new NOFA projects.

Table 7. Affordable Housing Fund Balance – September 2014

Type of Housing Funds	Available Balance
Below-Market-Rate Funds	\$13,400,000
Housing Impact Fees	\$6,600,000
Rental Housing Impact Fees	\$2,800,000
Total	\$22,800,000

⁶ Some of the earliest apartment developments shown on Table 6 offered a smaller number of affordable units in lieu of paying the Rental Housing Impact Fee.

Affordable housing developers have been very interested in the City's current NOFA, but in Mountain View's intense development environment, they have been unable to compete for residential properties. Market-rate developers are paying prices higher than the appraised property values and have secured the best properties for residential development. Under the current NOFA, the City has received an application for an 81-unit family development. This application will be forwarded to the NOFA Ad Hoc Committee in October and potentially on to Council for a reservation of funding on December 2, 2014. A second NOFA application for a 51-unit family development was submitted on October 1, 2014 and will be first reviewed by staff before going to the NOFA Ad Hoc Committee probably early next year. Preliminary budget estimates indicate that these two projects may need \$21 to \$25 million in City loans to subsidize the projects.

For the past two years, development activity has increased significantly, which has resulted in unusually high housing fee revenues; about \$9.6 million in Fiscal Year 2012-13 and \$8.4 million in Fiscal Year 2013-14. There are still numerous projects in the development revenue pipeline that are likely to contribute fees in the next five years.

RECOMMENDATION

- Make no changes to the BMR In-Lieu Fee at this time due to the pending California Supreme Court case on San Jose's inclusionary ordinance.
- If Council wants to consider an increase in the Rental Housing Impact Fee, staff would recommend increasing the \$10.26 per-habitable-square-foot fee to a fee within the range of \$14.00 to \$22.00 per habitable square foot.
- If Council wants to consider an increase in the Housing Impact Fee, staff would recommend increasing the \$10.26 per-square-foot fee to a fee within the range of \$11.68 to \$20.76 per square foot for office/high-tech/industrial development more than 10,000 square feet and half of that fee for development up to 10,000 square feet. Staff does not recommend increasing the fee for retail/entertainment/hotel.
- Provide direction on the effective date of any modified housing fees. In 2012, Council postponed the effective date of the modified Housing Impact Fee by roughly five months.

NEXT STEPS

1. Council provides direction to staff at the Study Session concerning which fee increases to consider at the December 9, 2014 public hearing and any additional information needed for the hearing.
2. Outreach meeting with stakeholder developers if Council chooses to consider increasing one or more fees.
3. Public hearing on December 9, 2014 to take action on fee increases.

PUBLIC NOTICING – Agenda posting.

LL-RT/3/CAM
860-10-14-14SS-E

- Attachments:
1. Nexus Study for Rental Housing Impact Fee
 2. Nexus Study for Housing Impact Fee
 3. [December 11, 2012 Council Report](#)