Agenda Item #12.1
For Council Meeting of: 12-10-2013

CITY OF SANTA ROSA
CITY COUNCIL

TO:	MAYOR AND CITY COUNCIL
SUBJECT:	HOUSING IMPACT FEE AND AMENDMENT TO CITY CODE CHAPTER 21-02
STAFF PRESENTER:	LISA KRANZ, SUPERVISING PLANNER COMMUNITY DEVELOPMENT
AGENDA ACTION:	INTRODUCTION OF ORDINANCE, ADOPTION OF RESOLUTION

ISSUE(S)

Should the City Council 1) introduce an ordinance amending City Code Chapter 21-02.090(A) revising the timing for payment of the housing impact fee for for-sale units; and 2) adopt housing impact fees for for-sale and rental housing?

COUNCIL GOALS/STRATEGIES

Council Goal 5 is: Improve the Partnerships between Neighborhoods, Community Organizations, Schools, and the City to Support and Promote Thriving, Inclusive, and Diverse Neighborhoods. A strategic objective supporting this goal is to: Seek Opportunities to Increase Affordable Housing and Emergency Housing Beds.

The proposed housing impact fee would support the future development of affordable housing, thus is related and consistent with this council goal.

BACKGROUND

1. The City Council directed development of nexus studies upon revision of the Housing Allocation Plan in fall 2012. The purpose of the nexus studies was to analyze and potentially revise the City's housing impact fee. The housing impact fee addresses the impacts that the development of new market rate housing will have on the need for affordable housing by helping to fund future development of housing affordable to very low and low income households. This fee is applied to new dwelling units and since its inception in 1992, has assisted the development of 1,630 lower income units.

2. The City hired Economic and Planning Systems to prepare the studies, "Nexus-Based Affordable Housing Fee Analysis for For-Sale Housing" and "Nexus-Based Affordable Housing Fee Analysis for Rental Housing," which were

completed in February 2013. The studies, attached to this report, identify the maximum fee that may be charged to mitigate the impacts of market rate housing on the demand for affordable housing. Proposed fee schedules were developed after extensive review of a variety of scenarios consistent with the nexus studies for both for-sale and rental housing. Four meetings with stakeholders were conducted regarding the nexus studies and the draft fee schedules.

3. On September 24, 2013, the City Council held a public hearing and considered revision to the housing impact fee and to the city code section which refers to the timing of payment of this fee. When the fee was considered in September, the council requested more information on its potential impact on smaller units, noting possible impacts to entry level housing and units in the city's two station plan areas. Council members were also interested in how to ensure a fee revision was revenue neutral to assure continued funds to provide affordable housing.

4. Staff and the city's consultant have reviewed residential permits issued from 2005 through fall 2013 and have used the unit size as a basis for comparison for five alternative fee scenarios for both for-sale and for-rent units. The following provides details and draws conclusions from this analysis.

ANALYSIS

1. **ALTERNATIVE FEE ANALYSIS – FOR-SALE HOUSING**

   The nexus study for market rate for-sale housing supports fees of about $8,900 to more than $26,000 per unit. Current housing fees for units larger than 900 square feet range from $1,008 to $37,750 (and higher for larger units) based on home prices from about $200,000 to $1,000,000. The nexus study identified that current fees for larger, more expensive units are too high and must be reduced.

   Staff recommended the housing impact fee for all for-sale units, regardless of size, be 2.5% of the unit's sales price. This factor (2.5%) is generally the maximum fee that could be charged for higher priced units based on the nexus study.

   While the maximum fee supported for smaller units ranges from 3 to 4.5%, staff determined that this rate would result in a fee that was too high based on feasibility considerations, so 2.5% of sales price was proposed for smaller units as well as larger, more expensive units. This model would assure that the for-sale unit fee continue to capture increases in market rate prices which comports with the methodology of the nexus study.

As noted, the City Council was concerned about the impact of the fee on the feasibility of smaller units as well as interested in identifying a fee that would be revenue neutral, having revenues similar to the current fee. Five fee alternatives were reviewed to provide additional information on which to base a recommendation.

FEE ALTERNATIVES

The alternatives compared include:

1) The current square footage based fee;
2) 2.5% of unit value (the staff recommendation);
3) Current fees with some reduction, which is basically keeping the fees the same except where the nexus study shows they must be lowered;
4) Maximum supported by the nexus study; and
5) Scaled revenue neutral. This alternative maintains generally the same revenue that the current fee does by adjusting the percentage of the nexus maximum supported fee. For example, units up to 1,100 square feet pay 30% of the nexus maximum; those up to 1,550 pay 60%, and so on.

The comparison was based on the square footage of residential units issued building permits by the City's Department of Community Development from January of 2005 through fall 2013 for units subject to the Housing Allocation Plan. Unit value was based on per square foot sales data. Based on approximately 1,100 for-sale units during this time period, the fee alternatives resulted in the following estimated revenue:

Alternative	**Current Fee**	**2.5% Value**	**Some Red.**	**Nexus Max**	**Rev. Neutral**
Revenue	$13,301,672	$13,443,300	$12,358,005	$17,593,172	$13,304,244

Based on these alternatives, staff recommends that the housing impact fee for for-sale units be set based on the 2.5% of value formula. This fee is the most closely linked with the nexus study, since it better reflects the relationship between the price of a unit, the income needed to purchase it, and the nexus-based need for services and its demand on the need for affordable housing.

In addition, based on the sample, this fee is very close to the revenue neutral option. The 2.5% of value fee generates about 1% more revenue for affordable housing than the current fees would in this example. Examples of the fees which would result at various sales prices, and a comparison to existing housing fees is attached.

As noted, this option does increase fees for smaller, for-sale units. This issue is discussed in greater detail later in this report.

2. **ALTERNATIVE FEE ANALYSIS – RENTAL HOUSING**

The nexus study for rental units indicates that fees of $7,583 to $12,741 are supported based on the impact from market rate rental units on the demand for affordable housing. Current fees range from $0 (for exempt units 900 square feet or less) to $5,516 (assuming a 1,280 square foot unit) or more for larger units.

FEE ALTERNATIVES

The alternatives compared include:

1) The current square footage based fee;
2) Maximum supported by the nexus study;
3) 15% of the nexus maximum (the initial staff recommendation);
4) Adjusted Top and Bottom. Current fees, but adding a nominal $1 per square foot fee on units of 900 square feet or less, which are now exempt, and reducing fees for larger, more expensive units where the nexus study shows fees must be lowered; and
5) Scaled revenue neutral. This alternative maintains generally the same revenue that the current fee does by adjusting the percentage of the nexus maximum supported fee. For example, units up to 900 square feet pay 10% of the nexus maximum; those up to 1,300 pay 50%.

The comparison is based on square footage of units in the sample, translated to unit type (studio to 3 bedroom) as appropriate. Based on approximately 90 rental units permitted during this time period, the fee alternatives resulted in the following estimated revenue:

Alternative	**Current Fee**	**Nexus Max**	**15% of Max**	**Adjusted Top/Bottom**	**Rev. Neutral**
Revenue	$446,376	$1,091,713	$163,757	$440,602	$445,794

Based on these alternatives, staff recommends alternative 4, maintaining the current fees based on unit square footage, but eliminating the exemption of units 900 square feet or smaller. Charging the fee for smaller units at $1 per square foot would acknowledge that smaller market rate units do have an impact on the need for affordable units, while keeping the fee itself relatively small. The current fee schedule based on unit square footage is attached.

Based on the sample of units, the revenue for this alternative is close to revenue neutrality, about 1% less.

3. **FEASIBILITY OF SMALL UNITS**

Background: Station Area Plans and the Housing Allocation Plan. Until the Housing Allocation Plan (HAP) was revised in November 2012, units in a mixed use development were exempt from the Housing Allocation Plan. This meant that housing units that are part of an integrated project including residential and non-residential components were not required to provide affordable units on site or pay fees to support their future development.

The exemption for mixed use development was initially included in the HAP to provide an incentive for the development of these types of projects. Construction costs of mixed use projects can be high in comparison to lower scale residential development, and an additional requirement was viewed as potentially negatively affecting the financial feasibility of mixed use projects.

The issue of eliminating the mixed use exemption arose during the development of the Downtown Station Area Specific Plan in 2006. Because there are few parcels in the downtown area which are 15 acres or larger (formerly the HAP trigger for provision of on-site affordable units), and much of the new development is planned to be mixed use, there was community concern that limited affordable housing would be developed downtown. A policy was included in the specific plan to eliminate the mixed use exemption and change to a unit based trigger to pave the way for a HAP requirement for on-site affordable housing downtown. This direction was later incorporated in general plan policy.

As noted, the HAP exemption for mixed use development was eliminated with its revision last year. In addition, to acknowledge and potentially forward the downtown station plan's goal of affordable housing, the revised housing Allocation Plan notes in Section 21-02.090(C) that:

> *Housing impact fees paid by projects located downtown shall be utilized for development of housing affordable to households of lower incomes and proposed to be located downtown, as possible. If no such developments are proposed when these funds become available, the fees may be utilized for the development of lower income units outside of downtown.*

Fee impact on smaller units. The council was concerned about the housing impact fee's effect on the feasibility of smaller units in the City's two station plan areas as well as small, entry level for-sale units in general. As illustrated in the above history, feasibility of small units in mixed use configurations has been a concern and was the purpose of a long standing HAP exemption for mixed use development.

The recommended fee for smaller, for-sale units less than 1,800 square feet and about $450,000 is higher than the current fees. They are approximately 5 to 140% times greater than the current housing fee for similarly sized units. Some examples from the proposed fee schedule:

Unit Size (Sq. Feet)	Assumed Value ($250/Sq. Ft.)	Recommended Fee (2.5% of value)	Current HAP Fee	Difference
1,000	$250,000	$6,250	$2,617	$3,633
1,200	$300,000	$7,500	$4,734	$2,766
1,400	$350,000	$8,750	$6,684	$2,066
1,600	$400,000	$10,000	$8,662	$1,338
1,800	$450,000	$11,250	$10,704	$546

More detail is found in the attached fee schedule for for-sale housing.

Most smaller units in the station plan areas are likely to cost around $300,000 to build. With the higher densities anticipated in these areas, construction and parking costs may be higher than in other areas of the city, and land acquisition costs are also likely to be comparatively high. At these development costs, developers will need the market to support unit sales prices of at least $350,000 and higher to achieve project feasibility, with or without an increase in the housing fees. This required pricing level is expected to exceed affordable prices for Santa Rosa households at moderate or lower income levels, so it is not expected that an increase in fees for smaller units in these areas would result in reduction of units that would otherwise be affordable.

Since the economic downturn, feasibility of units in the station plan areas, along with other areas of the city in general, has been affected. As the housing market returns, these units will be more feasible.

Fees for rental units are proposed to remain the same except for units of 900 square feet or less. With a proposed $1 per square foot fee for these units, the highest fee would be $900, which considered on a per unit basis, is a minor fee, well below 1% of total development costs.

4. **REVENUE TO ASSIST AFFORDABLE HOUSING**

The housing impact fee is one of the only local sources of funding for development of affordable housing since the dissolution of Redevelopment in California and the 20% set-aside it provided. The other is the Real Property

Transfer Tax, which is an annual set-aside from the General Fund which provided $123,000 for affordable housing production in 2012. Consistent with City Council Policy 000-48, 20% of the Real Property Transfer Tax is directed to affordable housing and homeless services annually.

Two federal sources, HOME and Community Development Block Grant funds, are available to the City. HOME funds for Santa Rosa provided $534,000 last year for predevelopment and development of affordable housing; Community Development Block Grant funds contributed $1.3 million toward affordable housing development in 2012. The amount of federal funding Santa Rosa receives annually is tied to the federal budget and fluctuates from year to year. Thus, it is not a predictable funding source.

The housing impact fee generated $620,000 in 2012 and is the most important local source for affordable housing development in Santa Rosa. It has generated more than $25 million (including loan repayment and interest) since 1992.

Housing fees collected are provided to affordable housing developers to make their projects more competitive for state and federal funds needed to develop a project as well as to subsidize affordable housing units by assisting with predevelopment costs, site preparation, and construction.

The City has collected an average of about $630,000 annually over the last five years in housing fees. Based on recent average subsidies per unit, this will support about 5 or 6 new affordable dwelling units per year.

5. **CITY CODE AMENDMENT**

To allow the housing impact fee to be paid no later than the close of escrow for for-sale units, a change to the city code is required, since the current language in the Housing Allocation Plan requires the fee to be paid no later than the final inspection. Close of escrow is later than the final building inspection, so code language is proposed which would clarify that fees for rental units shall be paid no later than final inspection and fees for for-sale units would be paid no later than close of escrow. Should a planned for-sale unit ultimately not be sold, the proposed ordinance allows the fee to be paid one year after the unit’s final inspection.

6. **CONCLUSION**

Based on the analysis, staff finds that the proposed for-sale housing impact fee at 2.5% of unit value and the rental housing fee, based on the existing per square foot model and no longer exempting units 900 square feet or less, charging those at $1 per square foot, will achieve similar revenue as the current fee structure.

RECOMMENDATION

It is recommended by the Departments of Community Development and Economic Development and Housing that the City Council introduce an ordinance amending City Code Chapter 21-02 (Housing Allocation Plan) and adopt a resolution revising housing impact fees for for-sale units and adding rental units less than 910 square feet to the existing fee schedule.

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Attachments:

- Nexus-Based Affordable Housing Fee Analysis for Rental Housing, February 20, 2013
- Nexus-Based Affordable Housing Fee Analysis for For-Sale Housing, February 20, 2013
- Proposed Fee Schedule for For-Sale Housing
- Housing Allocation Plan Fees from Current Fee Schedule
- Correspondence