NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
SILICON VALLEY CHAPTER

December 2, 2014

Ms. Suzanne Ize, Housing Officer
City of Sunnyvale CDD, Housing Division
456 W. Olive Avenue
Sunnyvale, CA 94085

Re: Sunnyvale Council for December 9, 2014
Economic & Planning Systems, Inc. (EPS) Housing Mitigation Fee Nexus Study dated September 8, 2014

Dear Ms. Ize,

NAIOP Silicon Valley appreciates Sunnyvale Housing Department and EPS for holding informational stakeholder meetings to review the EPS Housing Mitigation Fee Nexus Study on September 24th and October 13th. City staff and EPS representatives provided an overview of the EPS Nexus Study methodology, data analysis and fee calculations.

Following the October 13th informational stakeholder meeting NAIOP Silicon Valley commissioned a peer review of the EPS Nexus Study by Development Financial Advisors (DFA). At the conclusion of DFA's peer review the following issues remain a concern to the commercial real estate community i.e., (1) not all lower-wage workers employed in new commercial development will be new workforce, (2) not all new lower-wage workers will choose to live in Sunnyvale, thereby not impacting the need for new or additional affordable housing and (3) not all new lower-wage workers will create new lower-wage households.

Through various studies, including the Joint Center for Housing Studies of Harvard University, there is a growing body of evidence that the two principal forces behind housing affordability are restrictions on residential development and the growth in low-wage and part-time employment. Additionally the continual escalating cost of residential housing is driven by inadequate housing supply, restrictive land use regulation, infrastructure costs, impact fees and rising labor costs.

EPS warns that the maximum fee contained in their study for Office/R&D/Light Industrial ($113.99/sq. ft.) *may represent too high a cost burden to sustain development feasibility, and/or may account for housing impacts already addressed in other City programs, so adjustments downward from the maximum fees may be warranted.* The economic vitality of the City of Sunnyvale depends on a strong commercial real estate market and NAIOP strongly encourages the Council to heed EPS own warning!

NAIOP Silicon Valley believes that the city has been very effective in attracting strong economic investment. While it is important to provide housing to an economically diverse community NAIOP believes the critical priority for the City is to insure the continuation of a strong jobs based economy. For these reasons, NAIOP Silicon Valley recommends the adoption of a city-wide commercial impact fee, not to exceed, $12/sq. ft./net new construction for Office, R&D and Light Industrial.

Patricia E. Sausedo, Executive Director
NAIOP Silicon Valley

Attachment: DFA Peer Review EPS Nexus Study for Sunnyvale

Cc: Mayor & Council

ATTACHMENT 9

Linkage Fees: Strategies and Policy Recommendations In Silicon Valley

Prepared for

NAIOP

COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION

Patricia Sausedo, *Executive Director*
NAIOP Silicon Valley

November 2014

Table of Contents

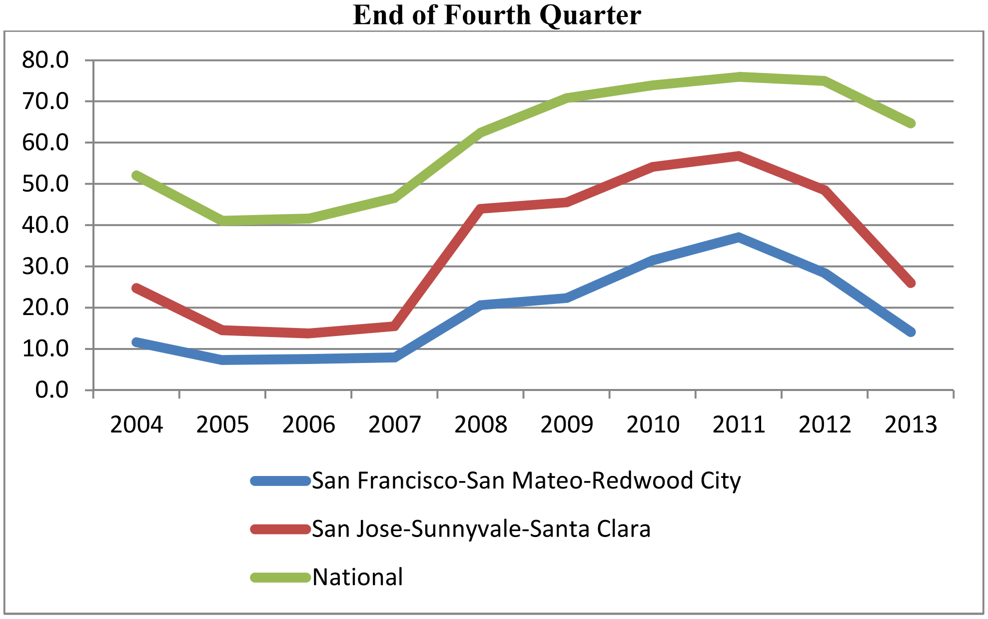
Introduction

The concept of a jobs-housing linkage fee on commercial development is to mitigate the impact of commercial development on the demand for affordable housing. The developer is asked to either provide the benefit directly or to pay fees that are directed towards providing the benefit. For example, the developer is asked to either build affordable housing units as part of the new development or pay in-lieu fees that will go towards providing affordable housing units. This White Paper provides: (i) an overview of the use of jobs-housing linkage fee programs in Silicon Valley, (ii) describes the impact associated with increasing fees on commercial development and, (iii) explores supplementary or alternative funding options to help absorb the increasing cost associated with affordable housing.

The Basis for Jobs-Housing Linkage Fees

As indicated by the Housing Opportunity Index (HOI) prepared by the National Association of Home Builders (NAHB) and Wells Fargo, cities in the Silicon Valley[1] continue to lead the nation in offering the least affordable homes. The HOI shows San Francisco as the least affordable city in the nation from 1991-2001 and has taken the crown back from the New York and Los Angeles housing areas since 2012.[2]

Figure 1
Housing Opportunity Index in Silicon Valley MSAs
End of Fourth Quarter



Source: NAHB/Wells Fargo

[1] Cities in the Silicon Valley include San Francisco, Burlingame/Hillsborough, San Mateo, Foster City, Menlo Park/Atherton, Palo Alto, Mountain View, Sunnyvale, Los Altos, Fremont, Milpitas, San Jose, Cupertino, Saratoga and Los Gatos. Source: Silicon Valley Regional Center. www.siliconvalleyeb5.com

[2] "The NAHB/Wells Fargo Housing Opportunity Index: History of Least and Most Affordable Areas" available at www.nahb.org.

According to the NAHB and Wells Fargo, the HOI for the second quarter of 2014 is 11.1 in the San Francisco-San Mateo-Redwood City MSA (or 11.1% of homes sold in the second quarter were affordable to families earning the area's median income of $100,400) and 21.5 in the San Jose-Sunnyvale-Santa Clara MSA (or 21.5% of homes sold in the second quarter were affordable to families earning the area's median income of $100,900). The national average in the second quarter of 2014 was 62.6 (or 62.6% of homes sold in the U.S. in the second quarter were affordable to families earning the national median income of $63,900).

Since the loss of redevelopment agencies and the State court prohibition of rental inclusionary zoning, cities have increasingly relied on impact fees to support affordable housing. To provide additional resources to increase affordable housing unit production, commercial linkage fee programs have been implemented by several cities in the Silicon Valley area. Revenues generated by the fee are intended to help fund the development of affordable housing units within accessible commuting distance to the center of employment. Linkage fees vary by type of commercial development, such as office, hotel, retail or industrial and different development types maybe charged separate rates per square foot of development, due to the differing levels of impact. The size of linkage fees varies by construction, with office and R&D development categories generally having higher linkage fees than other building categories. This is seen in Silicon Valley cities, as shown in the table below.

Table 1
Jobs Housing Linkage Fee Programs (2014)

Jurisdiction	Building Category	Fee per SF	Exemptions / Threshold
City and County of San Francisco	Office R&D Entertainment and Retail Integrated PDR and Small Enterprise	$24.03 $16.01 $22.42 $18.89	25,000 GSF threshold
City of Palo Alto	Commercial and Industrial	$19.31	Not-for-profits, education, hospitals, recreation
City of Menlo Park	Office and R&D All other	$15.19 $8.24	Not-for-profits, education, hospitals, recreation
City of Sunnyvale*	Office/R&D and Light Industrial (located within industrial zoning districts)	$9.74	Applies only to portion of project in excess of allowable FAR
City of Mountain View	Office, Industrial and High-Tech Hotel, Retail and Entertainment	$10.26 $2.60	Fee is 50% less if meets threshold: Office<10,000 SF Hotel<25,000 SF Retail<25,000 SF
City of Cupertino	Office, Industrial, Hotel, Retail, R&D Planned Industrial Park Zones	$6.00 $3.00	No minimum threshold

*Sunnyvale: Updated study underway at the time of preparation of this paper.

Jobs-housing fees significantly impact the decision making process of commercial developers and builders, including "go" or "no go" decisions to move forward on projects when deciding among various locations.

Existing Public Policy and Impacts to New Development

Public policy towards linkage fees attempt to strike a balance between the impact of growth in non-residential development to accommodate job expansion and stimulating affordable housing for workers.

The assignment of 'responsibility' behind the lack of housing affordability and the derivation of linkage fees is subject to debate. Policy regarding the use of linkage fees should consider the origin of affordability problems. What causes or perpetuates the need for affordable housing? According to the Joint Center for Housing Studies of Harvard University, "evidence is mounting that the two principal forces behind housing affordability problems are restrictions on residential development and the growth in low-wage and part-time employment." "Affordability problems are most acute in housing markets with the strictest land use regulations." Are these problems associated with the development of nonresidential land uses? Do linkage fees look at the big picture regarding the positive economic impacts (new tax revenue) new development provides to a local economy?

Funding affordable housing via linkage fees often creates an inequitable environment because it only applies to new development and not to existing property. A significant amount of initial costs to fund the gap in affordable housing is burdened by new development, sometimes without consideration for other funding sources. At times, this inequity among "new" and "existing" developments is further exacerbated due to different tax provisions. According to a study prepared by the California Tax Reform Association in 2012, "hundreds of acres of prime commercial land are taxed at very low values."[3] The study points out that in some areas of commercial lands, assessed values and property taxes for major companies are fixed at a level from a generation ago. It provides an example of Intel, which is located on 36 acres of desirable land taxed at 2 cents per square foot, or $980 per acre; another is IBM, which pays $202 per acre on 200 acres of land. In comparison, Google recently bought commercial land that generates $1.35 in tax per square foot, or $58,000 per acre in tax, about 60 times Intel's tax. Public policy can assist with providing for a more equitable approach to funding public benefits and provide a more competitive playing field within their respective jurisdictional boundaries.

Linkage fees can be a variable in the decision-making process of land buyers. Linkage fees raise the costs of development, or might be reflected in lower prices paid by developers for land. The rise in development costs can have an opposite effect on the desire for more local employment growth as well as affordable housing units. One

[3] Goldberg, Lenny and David Kersten. "High Tech, Low Tax: How the Richest Silicon Valley Corporations Pay Incredibly Low Taxes on Their Land." *California Tax Reform Association* March 2012

cannot discount the landowner possibly changing his or her original intention for the land, which is to retain the property to generate income; however, a profit-driven landowner may seek an alternative use that will also generate income and reduce total development costs (for example, building a parking structure instead of office and/or retail buildings or mixed-use residential housing). A study prepared by the U.S. Housing and Urban Development (HUD) argues that although fair and reasonable levels of impact fees can be an efficient way to pay for growth-related infrastructure costs, impact fees "pose the greatest barrier to affordable housing when they are regressive or disproportionate to actual development costs."[4]

Affordable Housing Policy Recommendations

Impact fees and in-lieu fees for affordable housing collected by cities in Santa Clara County totaled over $25 million, or 53%, of the total $47.3 million funds received for affordable housing in 2013. This is in contrast to the 17% contribution share of impact fees and in-lieu fees for affordable housing in 2008 before the loss of redevelopment funding.[5] There are numerous, practical approaches to supply housing at all levels of affordability that can be supported by various means. For example, housing policies can have a significant impact on the effectiveness of providing affordable housing. Charter cities, especially, can have a profound impact to local housing policies, as they have relatively more autonomy in regards to governance than general law cities. In contrast, general cities are bound by the State's general laws. Zoning ordinances of charter cities are not required to be consistent with the city's general plan, unless the city has adopted a consistency requirement, for example.

Several actions and policies that may be considered and benefit affordable housing in the long term include:

- *Identifying additional funding sources for supplying affordable homes.*

    - Aggressively apply for available external funding. Both Federal and State resources can alleviate affordable housing funding gaps. Resources such as the U.S. Department of Housing and Urban Development's Community Development Block Grants and HOME Investment Partnerships Program. These funds are used to finance a wide range of affordable housing activities. HOME's requires participating jurisdictions match 25 cents of every dollar in program funds.[6]
    - Dedicate a percentage of tax revenues, such as tax increment, or levy new tax to fund affordable homes. As an example, in November 2012, voters

[4] U.S. Department of Housing and Urban Development. "Why Not In Our Community? Removing Barriers to Affordable Housing." An Update to the Report of the Advisory Commission on Regulatory Barriers to Affordable Housing. 2005 February.

[5] Mohsen, Raania, Kevin Zwick and Shannon McDonald. "Affordable Housing Funding Landscape and Local Best Practices." *Cities Association of Santa Clara County and Housing Trust Silicon Valley* 2 December 2013.

[6] U.S. Department of Housing and Urban Development. http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/programs/home/

in the City of Bellingham, Washington, approved Proposition 1, a low-income housing levy, by a majority vote. This imposes a tax of 36 cents per $1,000 of property value. It is expected to generate $3 million annually over seven years, for a total of $21 million to the Bellingham Home Fund to provide housing for lower-income families, seniors, veterans, and others at-risk or experiencing homelessness.[7]

- Consider issuing bonds, as part of the mix to fund affordable housing. In 2012, Houston voters approved Proposition E, which authorized the issuance of $15 million affordable housing bonds for the acquisition, construction, rehabilitation of affordable housing and the levying of taxes.[8]
- Utilize existing State financing mechanisms to fund affordable housing. In 1990, California enacted the Infrastructure Financing District Act, which authorizes cities and counties to create infrastructure financing districts (IFDs) and issue bonds to finance public improvements. Properties in the IFD do not have to be located in blighted areas and can overlap existing redevelopment project areas. IFDs may also receive tax increment from property within the district. In September 2014, California passed the Enhanced Infrastructure Financing Districts Act (Senate Bill No. 628), giving communities more authority to build infrastructure they deem would achieve their growth and sustainability goals. Jurisdictions may utilize provisions under SB No. 628 to support affordable housing. Affordable housing provisions are specified in Sections 53398.52, 53398.53, 53398.56, and 53398.63. In particular, Section 53398.53 states that an infrastructure financing district "may reimburse a developer of a project that is located entirely within the boundaries of that district for any permit expenses incurred and to offset additional expenses incurred by the developer in constructing affordable housing units pursuant to the Transit Priority Project Program established in Section 65470."[9]
- Introduce a transfer tax for the sale or transfer of commercial real estate. Although the City of Santa Monica, California in the November 2014 election failed to raise its transfer tax on real estate transactions of at least $1 million from the current $3 per $1,000 to $9 to support affordable housing, the bill (Measure H) can nevertheless be emulated in the Silicon Valley region.

[7] Bellingham City Low-Income Housing Levy Proposition (November 2012). www.ballotpedia.org
[8] Mellon, Ericka and Monica Rhor. "Voters approve most, possibly all, of city's $415 million bond package; HISD, Metro HCC also succeed." *Houston Chronicle* 6 November 2012.
[9] California Legislative Information. http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0601-0650/sb_628_bill_20140929_chaptered.htm. Text of the Transit Priority Project Program Section 65470 can also be found on http://www.leginfo.ca.gov.

- *Reviewing current housing and zoning ordinances and programs to examine for opportunities to make homes less expensive to build and more affordable.*

    - Provide incentives to residential developers that encourage a healthy supply of market rate homes, which could prevent home prices from significantly rising.
    - Introduce mechanisms that expire linkage fees if certain agreed-upon milestones are not met.
    - Eliminate regulatory barriers that hinder construction of affordable housing. A report by HUD cites several barriers affecting the construction of affordable housing, which includes increased environmental regulations, misuse of smart growth, excessive subdivision controls, expansion of impact fees, and obsolete building and rehabilitation codes, such as requiring the use of expensive materials. For example, New Jersey adopted a housing rehabilitation code that reduced rehabilitation costs by 25% and increased the number of rehabilitation by about 25%.[10]
    - Promote the use of surplus property for affordable housing construction, which would eliminate land costs and help in the affordability of housing. Further, while "affordable by design" such as smaller units, may not be necessarily affordable for lower income households, it may benefit entry-level workforce housing.[11]
    - Evaluate density bonus ordinances to consider greater flexibility for production of more low income housing.
    - Exempt new development that does not create a new impact. A new development that replaced an existing one does not increase its impact, unless the new development is bigger than the previous one. If the new development is bigger than the previous one, the linkage fee should be adjusted to reflect the incremental impact of the new development.
    - Eliminate or reduce linkage fees for rehabilitating blighted areas. The idea here is to encourage new development in economically depressed regions. For example, the City of Albuquerque has in their ordinance a full or partial waiver of impact fees for affordable housing projects that meet economic-based development projects.[12]
    - Amend an existing or prepare a "smart growth" plan that can reduce cost of development, with input from developers, the community and public agencies.

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[10] U.S. Department of Housing and Urban Development. "Why Not In Our Community? Removing Barriers to Affordable Housing." An Update to the Report of the Advisory Commission on Regulatory Barriers to Affordable Housing. 2005 February.
[11] Mohsen, Raania, Kevin Zwick and Shannon McDonald. "Affordable Housing Funding Landscape and Local Best Practices." *Cities Association of Santa Clara County and Housing Trust Silicon Valley* 2 December 2013.
[12] City of Albuquerque Code of Ordinance Section 14-19-15 ("Exemptions").

- *Providing financial alternatives to assist with linkage fee cost impacts on certain employment generating developments.*

    - Consider waivers or subsidies to specific commercial developments that may warrant subsidies. For example, the City of Mountain View may waive linkage fees if the nonresidential development project is constructed for a specific use that will not have employees or fewer than one employee per 2,000 square feet of gross floor area. Additional criteria include having the building designed and built such that it cannot be converted to a use that can house a larger number of employees, except by major reconstruction.[13] Commercial building construction for certain industries may also be given some form of credit towards linkage fees. Commercial construction for the technology sector, which utilizes office and/or R&D spaces, could be given linkage fee waivers or subsidies. Jurisdictions providing economic subsidies will require dissemination of certain information to the public regarding the subsidy pursuant to Assembly Bill No. 562.
    - Provide economic incentives that fulfill specific criteria established by the jurisdiction. The City of San Diego, for example, created Policy No. 900-12, which provides incentives such as expedited permit review processes and reimbursement of all or a portion of building and/or development-related fees as long as the business provides "significant revenues and/or jobs, promote the stability and growth of City taxes and other revenues, encourage new business and other appropriate development in older parts of the City, or respond to other jurisdictions' efforts to induce businesses to relocate from San Diego." The business must also be consistent with the City's Community and Economic Development Strategy.[14]
    - Consider amending Floor Area Ratio (FAR) restrictions.
    - Provide linkage fee deferral options consistent with timing of employment impacts (based on occupancy).

Conclusion

Linkage fees on commercial development continue to be used as a way to alleviate the low levels of affordable housing in the Silicon Valley region. The demise of redevelopment funding in California has increased reliance by cities on impact fees and in-lieu fees for affordable housing. Current housing policies may be outdated, warranting their review to examine for costly barriers to constructing affordable housing. These policy reviews and changes include a combination of using external funding, revising zoning ordinances, engaging in public-private collaborations and providing financial incentives to stimulate desirable economic activity and the construction of affordable housing.

[13] Ordinance to repeal Chapter 36 (Zoning Ordinance) and Add a New Chapter 36 (Second Reading). *City of Mountain View* 10 December 2013.
[14] City of San Diego Council Policy No. 900-12. Effective date May 15, 2001.

Housing Mitigation Nexus and Fee Study – City of Sunnyvale

On behalf of the City of Sunnyvale, a Housing Mitigation Nexus and Fee Study, dated September 8, 2014 ("Study") was prepared by Economic Planning Systems ("EPS"). The purpose of the Study is to "quantify the relationship between the growth in nonresidential land uses and the demand for and cost of affordable housing for the local workforce."

Nexus Review
In order to establish this relationship, the Study makes a number of working assumptions. The following assumptions are key to the Study findings:

- Nonresidential development will demand a new workforce.
- A portion of the new workforce will be lower-wage workers.
- Household formations occur when new lower-wage jobs are created.

A closer look at each of these assumptions raises questions. What the Study doesn't address includes the following:

- Not all lower-wage workers employed in new commercial development will be new workforce. While adjustments were made for young workers, further consideration should be made for existing residents fulfilling the local job market; such as unemployed workers or workers changing industries that will not create a new impact on affordable housing needs.
- Not all new lower-wage workers will choose to live in Sunnyvale, thereby not impacting the need for new or additional affordable housing. It is not reasonable to assume all new lower-wage workers would choose to live in Sunnyvale. For example, it is common that housing choices are made based on proximity to schools, family members, or based on the location of other household worker job locations.
- Not all new lower-wage workers will create new lower-wage households. The Study assumes that all household workers earn an equal wage. While it probable in certain instances, it is not reasonable to assume in all cases. It is common that one household worker or spouse may choose to work a lower-wage job to supplement a higher wage workers income.

Seemingly the Study attempts to generalize the makeup of the lower-wage worker and worker households. In some instances the assumptions might be accurate; however, blanket statements not supportable by data should be balanced with rational adjustments so not to knowingly overstate the results of the analysis.

The relationship between affordable housing needs and nonresidential development is subject to further examination and raises questions regarding the methodology of linkage fees. According to the Joint Center for Housing Studies of Harvard University, "evidence is mounting that the two principal forces behind housing affordability problems are restrictions on residential development and the growth in low-wage and part-time employment." "Affordability problems are most acute in housing markets with the strictest land use regulations." [1]

The cost of residential housing are driven by issues such as, commodity prices, labor costs, infrastructure costs and impact fees, public policy, land use regulations and housing supply. According to the City of Sunnyvale's "Nexus Based Affordable Housing Fee Analysis for Rental Housing", the growth of low-wage and part-time employment is driven by the spending habits of residents living in new rental housing. To "link" either of these issues to nonresidential development is inconsistent with the above sited findings as well as the City's other nexus-based study finding.

Summary

The Study notes that the maximum fee *"may represent too high a cost burden to sustain development feasibility, and/or may account for housing impacts already addressed in other City programs, so adjustments downward from the maximum fees may be warranted"*.

By suggesting adjustments downward from the maximum fee levels may be warranted due to the fact that housing impacts are already addressed in other City programs, the preparer of the Study acknowledges the Study is incomplete. In effect, the Study partly assigns the responsibility of establishing an appropriate fee level with City staff or City council. It is the responsibility of the preparer of the Study to meet the required findings of nexus law and it is these findings, after thoroughly evaluating and analyzing all relevant information, that establish a "maximum" fee level. To knowingly report a maximum fee that has not accounted for "other City programs" indicates a result and corresponding fee level that is inflated.

Linkages between nonresidential development and affordable housing are subject to debate. The costs to build housing and related affordability gaps are the result of numerous variables, as described in this review, and are arguably independent of nonresidential development. The Study chooses to assign nonresidential land use as the responsible party to mitigate the impacts of economic activity associated with local spending habits. The methodology is contradictory to the City of Sunnyvale's "Nexus Based Affordable Housing Fee Analysis for Rental Housing" conclusions regarding responsibility for the impact on and causation of affordable housing. These contradictions result in duplication of linkage fees among residential and nonresidential land uses and leave questions regarding the soundness of the proposed linkage fee program.

[1] Joint Center for Housing Studies of Harvard University. "The State of the Nation's Housing, 2006".