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REPORT TO PLANNING COMMISSION

SUBJECT
Consideration of Housing Mitigation Fee Nexus Study Findings and Alternatives
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REPORT IN BRIEF

In 2009 Council directed staff to study possible expansion and/or increase of the City's Housing Mitigation Fee, which is currently imposed only on certain industrial or office projects. This study, initiated originally as a study issue (**Attachment 1**), required the completion of a nexus study to meet legal requirements for imposition of a new development impact fee. Staff engaged a consultant to complete the nexus study and other analysis related to this project. The nexus study is provided in **Attachment 2** to this report. A feasibility study is provided in **Attachment 3**, and a slide presentation is provided in **Attachment 4**, all of which are described further below.

STAFF RECOMMENDATION:

- Alternatives 1, 2 and 4: Recommend that Council consider expanding the Housing Mitigation Fee to all net new square footage of all non-residential development projects in any zone; recommend that Council consider adopting a fee of $12 per square foot for office/industrial projects ($6 per square foot for first 25,000 square feet), and $6 per square foot for retail and lodging projects, both adjusted annually for inflation as part of the annual fee schedule adoption; and recommend that Council have the new fee apply to projects where a complete planning application is submitted after the effective date of the fee. The fee would apply to net new square footage with credit for any existing square footage. This recommendation would expand the fee program to retail and lodging uses that are not currently subject to the fee. While the rates in Alternative 2 are relatively similar to the current fee rate, most projects that are already subject to the fee would experience a significant increase in the total fee amount due, because the entire net new building square footage would be subject to the fee, rather than just the portion of the building that exceeds allowable floor area ratio for that site.

Although the nexus study demonstrates that a much higher fee could be assessed on all use types, other considerations, such as regional competitiveness, feasibility of desired uses (i.e., retail), the need for local jobs, and other City revenues generated by these developments (sales, property, and occupancy taxes) provide compelling reasons not to charge a rate significantly higher than that of Alternative 2.

BACKGROUND
This study was suggested originally as part of the City's 2008 Housing Strategy, then as a study issue in 2009, and was also included in the 2009 Housing Element implementation plan.

Attachment 1 provides the study issue paper, updated in 2013, with a brief background and description of the proposed study. This study issue was dropped only because it was already included in the 2009 Housing Element implementation plan. To complete this study, staff recently commissioned a nexus study of the City's current commercial linkage fee, also known as the Housing Mitigation Fee. This fee was adopted by resolution in 1983, codified in 2003, and updated in 2008. It is contained in Sunnyvale Municipal Code section 19.22.035.

The purpose of this report is to share the findings of the nexus study and allow the community to discuss the findings and some possible ways to adjust the current linkage fee consistent with the study findings and other community concerns and priorities. The nexus study, provided in **Attachment 2**, is a rather technical document. Some useful definitions are provided here for background.

- A commercial linkage fee is a fee that links new employment-generating development, such as new offices, stores or factories, with the need for more affordable housing for the new workers who will work in those developments.
- A nexus study is a study of the connection between new development of a defined type and size, and its potential impacts on a community, such as increased traffic, increased air or water pollution, increased demand for public facilities and services such as schools or policing, or increased demand for housing, to name a few types of potential impacts. Each nexus study usually focuses on one particular type of impact, such as increased demand for housing or for parks.
- A nexus study also examines how the particular impact of the development might be mitigated or resolved. Mitigation usually occurs in one of two ways: either by the developer providing the needed services, land or facilities directly, or by paying a fee which the City (or the school district or other agency imposing the fee) could use to mitigate the identified impact of the development.
- The California Mitigation Fee Act requires that any requirements placed on land development projects by the city or county, such as the requirements to pay a fee, dedicate land, or construct community facilities, be connected to, or "have a nexus with" the identified impacts of that project. It also requires that the amount of the fee or other required mitigation measure be proportional to the degree or scale of the impacts of that development. Typically this legal requirement is addressed by completion of a nexus study by the city or county that identifies both the type and scale or size of likely impacts of a project.

The nexus study provides important information about the type and scale of the impacts of new commercial development on the City's needs for affordable housing. This information will be helpful for the City and community to consider when evaluating potential adjustments to the City's current housing mitigation fee.

EXISTING POLICY

General Plan, Housing Element

Policy A.4: Continue to require office and industrial development to mitigate the demand for affordable housing.

ENVIRONMENTAL REVIEW

N/A

DISCUSSION

Current Housing Mitigation Fee

The City's current Housing Mitigation Fee has been in effect since 1983 and was last updated in 2008, at which time the fee was indexed to inflation. The fee, which was $9.49 per *applicable* square foot at the time the study was completed (currently $9.74/square foot), only applies to development in the City's industrial zones, and only on the portion of the new building that exceeds the maximum floor-area ratio (FAR) allowed at the site of the development (i.e., "applicable" square feet). In other words, if the zoning on a particular site in an industrial zone only allows a 50,000 square foot development due to the FAR limits in place, and the applicant seeks and obtains a discretionary approval to build a project of 80,000 square feet, the fee would only apply to the extra 30,000 square feet built in the project. In fact, a developer wishing to replace a 40,000 square foot building with a 50,000 square foot project on that same site would currently pay no housing mitigation fee at all (because the project, despite representing a net increase in square footage, would not exceed the maximum FAR allowed on site).

In addition, if an identical office project is built in a non-industrial zone, such as in areas zoned Office, Commercial, or within any of the specific plan zones such as Downtown Specific Plan or El Camino Precise Plan, it is not subject to the Housing Mitigation Fee. Similarly, this fee does not apply to any type of project, such as hotels, stores, or other places of employment, outside of the industrial zones, although all of those projects are employment-generating. Due to the somewhat limited application of the current Housing Mitigation fee, many have suggested its expansion to all employment-generating uses to better address the need for affordable housing generated by all types of employment-generating projects.

Study Procedure and Findings

In order to complete the nexus study, the City retained Economic Planning Systems, Inc., based in Oakland (EPS), a firm that has completed many studies of this type for clients throughout California. The scope of work included the following primary tasks:

- Define the nexus between new employment-generating (non-residential) development and the need for new affordable housing in the City. For this study, non-residential development was divided into three main types, to allow for more accurate analysis of the number and wage levels of workers in the developments. These three types included: office/industrial/research and development (R&D); retail; and lodging.
- Identify the maximum supportable nexus-based fee levels for each of the three development types.
- Study the financial feasibility of the various development types under the current Housing Mitigation Fee structure, the maximum supportable fee level, and a "suggested" fee level that would not impede development but would generate additional fees to support the housing needs generated by these developments. This suggested fee level is not a staff recommendation, but simply a fee level selected for feasibility testing. A staff recommendation will be developed for Council after completion of the outreach meetings and commission hearings on this topic.
- Survey the rates and structures of commercial linkage fees in other communities in the vicinity and the region for comparison.

The full report prepared by EPS is provided in **Attachment 2**. The third and fourth tasks listed above are summarized in a memorandum from EPS provided in **Attachment 3**.

The primary findings of the study are as follows:

1. The maximum nexus-supported fees calculated by EPS for Sunnyvale, shown in the table below, greatly exceed those currently imposed in Sunnyvale and other jurisdictions.

Project Type	**Maximum Supportable Fee Level * Per Square Foot** *(net new space)*
Lodging	$76
Retail / Restaurants	$295
Office / Light Industrial / R&D	$114

** Rounded to the nearest dollar*

2. Commercial fees charged by other Bay Area jurisdictions vary significantly based on geography and local development costs.
3. Jurisdictions have taken different approaches to how they apply the fees to the square footage of new projects.
4. EPS suggests charging well below the maximum nexus-based fee to all evaluated commercial uses (lodging, office/R&D, light industrial/flex, and retail), nearer the range of fees charged by comparable cities.

The report and memorandum explain the logical basis for the analysis that produced these findings, and shows all the background data used for the calculations in the appendices.

The report acknowledges that the maximum fee levels would likely make most development projects infeasible, and could lead to future difficulties in increasing local employment opportunities and/or retaining desired employers who wish to expand in the City. To address this concern, EPS tested a fee level, referred to in the Memorandum (**Attachment 3**) as Scenario A, that was closer to the average fee levels in those nearby cities that currently have linkage fees (Cupertino, Palo Alto, Mountain View and Menlo Park). This average was approximately $10 per square foot, as shown on page 4 of **Attachment 3**.

In addition, the feasibility test assumes the fee would apply only to net new square footage, which is the total square footage of the new project minus the square footage of any existing workplaces on the site, in order to reflect the net increase in employment level created by the new project.

Another adjustment made to the Scenario A fee level to minimize impacts on relatively small projects, which may have less financial basis from which to pay higher fees, was to reduce the fee level by half for any projects of 25,000 square feet or less, and also for the first 25,000 square feet of any larger projects, as shown below. The rate for lodging is less than the rate for other development types because its impacts on housing demand are significantly less, as shown on the prior page, due to the lower number of employees per square foot of lodging developments compared to the other types of development.

Project Type	**Scenario A Fees Per Square F** *(net new space)*	
	First 25,000 SF	***Any Additional***
Lodging	$3	$6
Retail / Restaurants	$5	$10
Office / Light Industrial / R&D	$5	$10

EPS tested the feasibility of fees under Scenario A, and found that they would not have significant impacts on the financial feasibility of such projects, measured in terms of impact on developer "return on costs," as explained in **Attachment 3.**

Public Outreach

The nexus study reports were published on the City's website at *LinkageFee.inSunnyvale.com* on September 12. Staff held two outreach meetings in late September and invited various stakeholders and community members to attend and comment on the study. Invitations to these meetings were sent by email to more than 2,700 emails on various outreach lists of community contacts and stakeholder groups, and posted in the City Manager's Blog, housing e-newsletter, and sent to several associations such as the Moffett Park Business Association and several regional housing groups.

Approximately 25 people attended the outreach meetings, including representatives of NAIOP, an industry group representing office and industrial developers, the Building Industry Association, various housing advocacy groups and housing providers, area residents, one representative of a company located in Moffett Park, and various others. Most of the attendees expressed support for expansion of the fee and for fee levels higher than the "suggested" level but not as high as the maximum fee level. Some attendees suggested testing a fee of $20 per square foot for feasibility. Following the outreach meeting, EPS tested the feasibility of this fee level, referred to as Scenario B in the Memorandum. The results of that test showed slightly higher, but not significantly different impacts on feasibility compared to Scenario A.

Industry representatives asked questions but did not express specific concerns or suggestions about fee levels, but indicated they would review and provide written comments later. The presentation provided at the outreach meetings, revised to add the results of the Scenario B feasibility test and an additional project example, is provided in **Attachment 4**.

In addition, the Planning and Housing and Human Services Commissions held a joint study session on this topic at the Planning Commission's October 13 meeting. Some commissioners expressed interest in providing lower fees for retail, due to the community's need for more of certain types of retail projects, and also due to the weaker market feasibility of retail projects in general, as shown in the feasibility study. Attendees also noted that all three use types provide sales and occupancy taxes and other types of revenue to the City. The Housing and Human Services Commission held a public hearing on this item during its regular meeting on October 22.

The table below provides the actual Housing Mitigation Fee amounts that would be due from the sample projects, described in **Attachment 4**, under the current Housing Mitigation Fee ordinance, Scenarios A and B, and under "Alternative 2", which is a rate of $12 per square foot for office/R&D

projects ($6 per square foot for first 25,000 square feet) and $6 per square foot for retail and lodging. The rate for retail is lower in this alternative in light of concerns expressed at the Joint Study Session regarding the community's desire for certain types of retail, and the more challenging feasibility context for retail in general, as shown in **Attachments 3** and **4**. In all cases, the fee would apply to the net increase in square footage, (net new square feet or "nn SF"), with credit provided for existing buildings to be demolished.

Project Examples	**Total of All Other City Fees**	**Current HMF**	**Scenario A HMF**	**Scenario B HMF**	**Alternative 2 HMF**
Rate/SF	*n/a*	*$9.49 (limited application)*	*$10/$10/$6**	*$20/$20/$20*	*$12*/$6/$6*
Office/R&D in 0.35 FAR Zone (73,400 nn SF, 0.5 FAR)	$562,000	$410,000	$612,000	$1,474,000	$734,000
Office/R&D in 0.5 FAR Zone (370,000 nn SF, 0.8 FAR)	$5,503,000	$1,860,000	$3,575,000	$7,400,000	$4,290,000
Hotel (57,800 nn SF)	$590,000	$ -	$272,000	$1,156,000	$347,000
Retail (35,000 nn SF)	$319,000	$ -	$225,000	$700,000	$ 210,000

** With 50% discount for first 25,000 SF of project.*

The range from Scenario A to Scenario B is considered to be a reasonable range within which to set the fees, given the regional context, as some neighboring cities, such as Mountain View, have fees similar to Scenario A, while other cities, such as Palo Alto, have fees similar to Scenario B, while others don't charge linkage fees at all, such as San Jose and Santa Clara. The average fee rates of those cities in Silicon Valley that have linkage fees are similar to the rates proposed in Alternative 2. These cities' linkage fee rates are shown in **Attachment 4** (Slide 9).

Although the nexus study demonstrates that a fee much higher than that of Scenario B could be assessed on all use types, other considerations, such as regional competitiveness, feasibility of desired uses (i.e., retail), the need for local jobs, and other City revenues generated by these developments (sales, property, and occupancy taxes) provide compelling reasons to set the fees within the range shown above. Alternative 2 appears to provide a good balance between the need to generate funds to address the housing impacts of these projects, and the other considerations noted above.

The City Council is scheduled to consider this item on December 9, 2014.

FISCAL IMPACT

The fiscal impact of a possible expansion or adjustment of the Housing Mitigation fee would depend on the fee rate and its application, and on future levels of development subject to the fee. One preliminary estimate of the potential impact, based on average annual square footage of non-residential development since 2000, indicate that a fee rate in the $10 range could generate annual revenues to the Housing Mitigation fund of approximately $6 million per year, assuming future development levels are similar to past levels. If the fee is set at levels that significantly impact project feasibility, it could have the unintended impact of halting or significantly decreasing levels of development, which could have a negative impact on the General fund and various other funds supported by development fees.

PUBLIC CONTACT

Public contact was made through posting of the Planning Commission agenda on the City's officialnotice bulletin board, on the City's website, and the availability of the agenda and report in the Office of the City Clerk. Additional public outreach efforts are described in the Discussion section above.

ALTERNATIVES

1. Recommend that Council expand the Housing Mitigation Fee to all net new square footage of all non-residential development projects, in any zone.
2. Recommend that Council adopt a fee of $12 per square foot for office/industrial projects ($6 per square foot for first 25,000 square feet), and $6 per square foot for retail and lodging projects, both based on net increase in square footage and adjusted annually for inflation as part of the annual fee schedule adoption.
3. Recommend that Council adopt a fee of $20 per net new square foot for office and retail ($10 per square foot for first 25,000 square feet), and $12 per net new square foot for lodging, both based on net increase in square footage and adjusted annually for inflation as part of the annual fee schedule adoption.
4. Recommend that Council have the new fee apply to projects where a complete planning application is submitted after the effective date of the fee.
5. Recommend that Council adopt a modified fee schedule with rates for each development type suggested by the Commission.
6. Make another recommendation to Council regarding this study.

RECOMMENDATION

Alternatives 1, 2, and 4: Recommend that Council expand the Housing Mitigation Fee to all net new square footage of all non-residential development projects, in any zone; recommend that Council consider adopting a fee of $12 per square foot for office/industrial projects ($6 per square foot for first 25,000 square feet), and $6 per square foot for retail and lodging projects, both based on net increase in square footage and adjusted annually for inflation as part of the annual fee schedule adoption; and recommend that Council have the new fee apply to projects where a complete planning application is submitted after the effective date of the fee.
Staff recommends the approach provided in Alternatives 1 and 2 as a fair way to require new employment-generating developments to at least partially mitigate the need for affordable housing for the workers who will be employed at these new workplaces.

While Alternative 3 is fully justified based on the nexus study, other considerations balance the arguments for a higher fee. These include meeting the City's economic development goals for attracting employment, retail and hospitality uses, the fiscal benefits (property, sales and occupancy taxes) that these uses bring to the City, and the objective of staying within the range of fees charged by other nearby cities that charge such a fee. Staff also acknowledges that although Sunnyvale has had a housing mitigation fee in place since the 1980s, many surrounding cities do not levy such a fee on non-residential development.

There are not many other sources of funding available to address these needs. The proposed alternatives would be consistent with the Mitigation Fee Act and the nexus study findings.

While the rates in Alternative 2 are similar to the current rate, most projects that are already subject to the fee would experience an increase in the total fee amount due, because the entire net new building square footage would be subject to the fee. Additionally, Alternative 2 would expand the fee program to retail and lodging uses that are not currently subject to the fee. While Alternative 3 does not substantially change project feasibility relative to Alternative 2, it does represent a significant increase in fees which may deter some projects desired by the community, such as new retail developments. Staff is not recommending Alternative 3 at this time, although it could be considered through a phased increase.

If Council approves one of these alternatives or some variation thereof at its meeting on December 9, staff would also seek Council direction at that time to return to the appropriate commissions and Council within several months with a draft ordinance implementing the proposed changes to the Housing Mitigation Fee. In that case, staff would recommend that the new fee be applied to projects for which a complete planning application is submitted on or after the effective date of the amended ordinance and fee schedule.

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Reviewed by: Robert A. Walker, Assistant City Manager
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ATTACHMENTS

1. Study Issue: Review of the Housing Mitigation Fee
2. Nexus Study Report
3. Feasibility Study Memorandum
4. Outreach Presentation