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# REPORT TO PLANNING COMMISSION

## SUBJECT

Introduce an Ordinance to add Chapter 19.77 ("Inclusionary Below Market Rate Rental Housing") to Title 19 ("Zoning") of the Sunnyvale Municipal Code to create an Inclusionary Rental Housing Program, and adopt a Resolution to amend the Master Fee Schedule and create a Rental Housing In -Lieu Fee.

## REPORT IN BRIEF

Since 1980, Sunnyvale has implemented an inclusionary housing requirement that a certain percentage of new residential ownership and rental development be deed restricted as affordable housing to low or moderate income households. In 2009, the California court case *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles* eliminated rental housing inclusionary programs across the state. For-sale inclusionary programs were not affected by the court decision. Since that time, Sunnyvale has not been able to require any new inclusionary housing rental units but continued to enforce existing rental inclusionary units already in the program pursuant to SMC Chapter 19.69. In addition, the City has approved a number of residential developments that took advantage of the State Affordable Housing Density bonus (and included deed restricted affordable units) or imposed a Rental Housing Impact Fee to be used to support non-profit developers in the creation of new affordable housing. In 2017, California's Governor approved legislation which once again allowed California jurisdictions to implement inclusionary rental housing programs (AB 1505). This legislation is sometimes referred to as the "*Palmer* fix" as it relates to the court decision referenced above. During that same year, the Sunnyvale City Council approved Study Issue 17-09, the 2017 Housing Strategy, of which one goal is to enact a rental inclusionary ordinance consistent with AB 1505.

After analyzing neighboring jurisdictions' rental inclusionary programs and holding several community workshops and stakeholder meetings, staff is recommending the Council Introduce an ordinance to add Chapter 19.77 ("Inclusionary Below Market Rate Rental Housing") to Title 19 ("Zoning") of the Sunnyvale Municipal Code to create an Inclusionary Rental Housing Program (Attachment 3), which would require rental developments to set aside 15 percent of new rental developments to very-low and low income households. In addition, staff is recommending Council adopt a Resolution (Attachment 4), to amend the Master Fee Schedule and create a Rental Housing In-Lieu Fee as an alternative compliance method.

## BACKGROUND

In 1980, Sunnyvale adopted an affordable housing ordinance, also known as an inclusionary housing program (RTC 80-556). The original ordinance, once found as Chapter 19.66, established the requirements of the Below Market Rate (BMR) Housing Program for both ownership and rental housing developments, with a 12.5 percent inclusionary for ownership and 10 to 15 percent inclusionary for rental, depending on vacancy rates. The inclusionary affordable housing requirements have been modified various times since then.

The City implemented a successful affordable rental inclusionary program until 2009 when inclusionary rental housing programs came to an abrupt halt after the California Court of Appeals in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles* held that inclusionary housing requirements for residential rental units are pre-empted by the Costa-Hawkins Rental Housing Act. Costa-Hawkins is the state's primary rent control law, which generally gives residential landlords the right to establish the initial rents payable by new tenants (and is applicable to units built after February 1, 1995). Since *Palmer*, many cities and counties repealed or declined to enforce their inclusionary rental housing programs.

To mitigate the continuously increasing demand of affordable housing in Sunnyvale during this time, the City Council adopted a Rental Housing Impact Fee for new rental housing in July 2015. All funds collected through this fee have been deposited into the City's Housing Mitigation Fund which is used to award grants and loans to non-profit housing developers to construct affordable housing in Sunnyvale. Over $50 million in Housing Mitigation Fund loans have been awarded since the fund was created.

In March 2017, the Sunnyvale City Council approved Study Issue 17-09, the 2017 Housing Strategy. The Housing Strategy brought together several study concepts related to addressing affordable housing with the general goal to refine the City's long-term housing strategy to identify potential improvements to existing programs and approaches, and/or potential new approaches to increase affordable housing stock and/or improve affordability of housing in the City.

In September 2017, California's Governor signed AB 1505, which modified the Costa-Hawkins Act and, in essence, supersedes the Court's ruling in *Palmer*. Cities and counties were once again authorized to adopt inclusionary housing ordinances requiring residential rental housing developments to include a specified percentage of affordable units as a condition of development. The new law did not limit the amount of affordable housing a City can require, but instead put authority in the California Department of Housing and Community Development (HCD) to review all city or county inclusionary housing ordinances that require greater than 15 percent of the total number of units in the development be affordable to lower income households.

In December 2017, the City Council considered a Work Plan for Housing Strategy (RTC No. 17-1069); the staff report explains that the Scope of Work was expanded slightly to accommodate additional tasks needed to analyze and respond to new State laws related to housing (the "2017 Housing Package"). One of those laws, the "*Palmer* fix" bill, allows cities to adopt or reinstate prior inclusionary housing requirements for rental housing. The City Council approved the Work Plan with direction to accelerate the evaluation of AB 1505 for City Council consideration prior to completion of the entire study. It is important to note that when the final Housing Strategy will be considered by the City Council in early 2020, the report may feature recommendations to enhance or modify the rental and/or ownership BMR programs. City Council will have the opportunity to decide on future direction of those programs at that time.

The City Council is scheduled to consider this item on September 24, 2019.

## EXISTING POLICY

**Sunnyvale General Plan, Housing Element**



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**GOAL HE-1 Adequate Housing:** Assist in the provision of adequate housing to meet the diverse needs of Sunnyvale's households of all income levels.

> Policy HE-1.3: Utilize the Below Market Rate Housing requirements as a tool to integrate affordable units within market rate developments, and increase the availability of affordable housing throughout the community.

## ENVIRONMENTAL REVIEW

This action is not a project for purposes of the California Environmental Quality Act (CEQA) because it is general policy and procedure making that will not result in a direct or indirect physical change in the environment (Guideline 15378(b)(2)). Each development subject to the Rental Inclusionary BMR Program will undergo environmental review as required.

## DISCUSSION

Sunnyvale has been a Silicon Valley pioneer in affordable housing programs since 1980, which is when the City adopted the below market rate (BMR) program. Over 550 ownership units have been developed and sold to income eligible households, while over 710 apartment units have been established through the former affordable rental program and the state Density Bonus Law program. The current affordable housing regulations can be found in Chapters 19.67 (Below Market Rate Ownership Housing), 19.69 (Existing Below Market Rate Rental Housing), and 19.75 (Housing Impact Fees) of the Sunnyvale Municipal Code.

### AFFORDABLE RENTAL HOUSING DEMAND

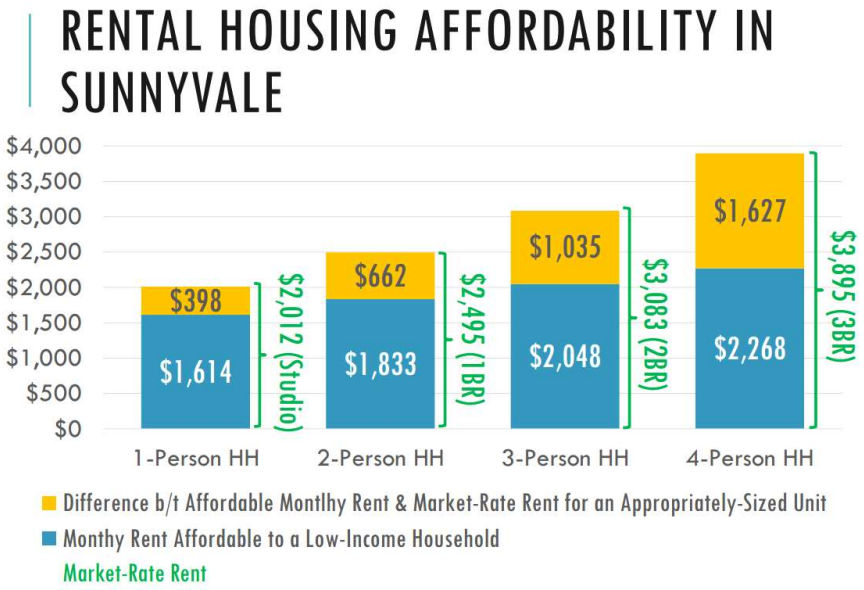
Market rate rents continue to increase at rapid rates throughout Sunnyvale and Santa Clara County, and demand for affordable housing continues to hit record highs. Per research conducted as part of the Housing Strategy:

- Rents in Sunnyvale have increased 78 percent since 2009.
- 75 percent of Sunnyvale renter households are considered cost burdened as they spend more than 30 percent of their monthly income on housing costs.
- 44 percent of Sunnyvale renter households are considered severely cost burdened for spending more than 50 percent of their monthly income on housing costs.

The difference between average rent and affordability continue to grow, as seen in the image below.



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*Source: Housing Strategy, BAE Consultants, February 12, 2019 Community Workshop*

## RESEARCH FOR PROPOSED RENTAL INCLUSIONARY BMR PROGRAM

While referring to Sunnyvale's former rental inclusionary program, staff reviewed the new inclusionary rental housing programs of various neighboring cities to identify best practices and to ensure that the recommendations proposed by staff are comparable to those of other cities. The results of that research indicated that most neighboring communities have reinstated their rental inclusionary programs, and require between ten to twenty percent of apartment units to be deed restricted for various income categories.

## PUBLIC OUTREACH EFFORTS

As part of the Housing Strategy, community wide workshops were held on February 12, 2019 and June 6, 2019; one developer stakeholder meeting was held on February 28, 2019, and various individual meetings with developers, over the past several months, to discuss the proposed terms of the new rental inclusionary program and obtain feedback. Final outreach efforts on this topic were held in August 2019.

Summarized comments from individuals at community meetings related to a rental inclusionary program are as follows:

- Please consider "*Palmer* fix" and "right to lease".
- Increase inclusionary housing requirements to 15 percent via ordinance. Desire to see higher percentage as allowed for Sunnyvale within Palmer fix parameters.
- Housing Strategy should include regulation to minimize displacement of renters in next five years and protections for low income residents, especially those whose jobs are here.
- Consider "missing middle" in any potential inclusionary rental ordinances.
- Explore ways to increase City revenues to help fund more affordable housing.

- City should provide inclusionary zoning for rental units.

Summarized comments from developer stakeholder meetings are as follows:

- Requirements for Very Low-Income units require more developer subsidy.
- Consider including moderate income units in the required mix.
- Flexibility is very important. If the requirements or fees are too high and projects are not feasible, no new housing will be built.
- If there is a zone where both office and residential are allowed, increasing affordability requirements may erode economics of residential and then office may outbid residential projects to buy land, making residential development infeasible.
- Higher density is needed in residential zoning to offset new costs and fees.
- Other regulatory incentives (e.g., reduced setbacks, more flexibility in the ability to provide parking in a wrap configuration) could help to encourage more on-site provision of affordable units.
- Provide more certainty in the entitlement process, including a fixed menu of incentives that are a given if certain conditions are met. Simplify the process.
- Fee reduction in inclusionary units would help feasibility. Sunnyvale has high fees that make development difficult with increasing land and construction costs.

During community workshops, the public participated in dot exercises to display support or opposition to various questions regarding the proposed inclusionary program, as summarized in Attachment 2.

**SUMMARY OF PROPOSED RENTAL INCLUSIONARY REQUIREMENTS**

Using all methods of analysis and outreach discussed above, the proposed Inclusionary Below Market Rate Rental Housing Program was prepared, as seen in Attachment 3. Key points of the program are as follows:

1. All new multi-family residential developments of three or more units are subject to the ordinance.
2. All new multi-family residential developments between three and six units may either provide 15 percent of units as affordable housing OR pay a “small rental project” in-lieu fee to meet inclusionary requirements.
3. All new multi-family residential developments of seven or more units must provide 15 percent of the units set aside for affordable housing; the large rental program in-lieu fee may be paid at the City Council’s discretion.
4. Of the 15 percent inclusionary requirement, 10 percent of the units must be deed restricted for low income households, and 5 percent of the units must be deed restricted for very-low income households.
5. Various alternative compliance options remain, at the sole discretion of the City Council, and are similar to the City’s current ownership BMR program.
6. Annual income limits and rent limits are published by the City of Sunnyvale; all deed restricted units must be priced accordingly.
7. Inclusionary rental units may be counted towards State Density Bonus Law units.

**EXISTING RENTAL HOUSING IMPACT FEE & PROPOSED NEW IN-LIEU FEE**

In 2015, the City of Sunnyvale adopted a Rental Housing Impact Fee (RIF) based on a ‘*Nexus Based Affordable Housing Fee Analysis for Rental Housing*’ prepared by EPS.

The report concluded that a nexus based fee is warranted for new market rate rental housing developments and that the maximum supportable impact fee for new apartment developments had a range as follows:

Table 1: 2015 Nexus Study Impact Fee Recommendations

| **Apartment Size** | **Maximum Nexus Based Fee** | |
|---|---|---|
| | **Fee Per Unit** | **Fee Per Square Feet** |
| Studio | $47,154 | $98.00 |
| One Bedroom | $47,593 | $60.00 |
| Two Bedroom | $66,042 | $55.00 |
| Three Bedroom | $85,343 | $61.00 |

The Nexus Study stated that charging the maximum fees is not recommended as that may hinder the City's efforts to meet its regional housing needs allocation as the fees may reduce feasibility on desirable housing developments. In 2015, Council approved a Rental Impact Fee (RIF) of $17.00 per new habitable square foot of rental housing. Rental Impact Fees went into effect in September 2015. The RIF increases annually with the Consumer Price Index. The FY 2019/20 RIF is $9.60 per square foot for "Small Rental Projects" (four to seven units), and $19.20 for "Large Rental Projects" (eight or more units).

Sunnyvale's RIF has not been reviewed since it was implemented in 2015. Staff has received various comments from the community affordable housing advocates voicing a need to review the fees and support for increasing the RIF to remain consistent with surrounding jurisdictions and to reflect the rising costs of developing affordable housing. With adoption of the Inclusionary BMR Rental Ordinance, a new Rental In-Lieu Fee will be created, and the existing RIF will remain for projects deemed complete prior to the date the new ordinance goes into effect (November 8, 2019, assuming Council action to introduce an ordinance on September 24, 2019).

**PROPOSED RENTAL IN-LIEU FEE**

Should the Council approve the Inclusionary BMR Rental Ordinance, a *Rental In-Lieu Fee* will be established. The new fee will serve to provide fees in-lieu of affordable rental units, while the old impact fee served to offset the impact that residential development created towards the demand of affordable housing. The Small Rental Project In-Lieu Fee will be a compliance option for small multi-family rental developments with three to six units; and the Large Rental Project In-Lieu Fee will be an Alternative Compliance Option for multi-family rental developments with seven or more units. Large Rental Project In-Lieu fees must be approved by the City Council.

Staff researched various neighboring jurisdiction's in-lieu fee payment options, which ranged from $20.00 per new habitable square feet in Cupertino to $34.57 in Mountain View; other cities require payment per inclusionary unit requirement, such as San Jose's $125,000 per inclusionary unit in-lieu fee. While a Nexus Study is no longer required to adopt inclusionary housing programs or fees, the 2015 Nexus Study was prepared recently enough, and covered such a broad range of acceptable fees, that the report was considered during fee analysis.

After reviewing the comparable in-lieu options, community outreach comments (as described above),

the Nexus Study, and comparing all to development costs of affordable housing, staff is providing three options for the Council to consider in setting the new Rental Housing In-Lieu Fee. Each fee option includes setting the small in-lieu fee at 50 percent of the large in-lieu fee, similarly to the Rental Housing Impact Fee approved by Council in 2015.

Table 2: Rental Housing In-Lieu Fee Recommended Options*

| Fee | Option 1 - *(Existing Impact Fee Rate)* | Option 2 | Option 3 | Potential fee per 800 square foot apartment (avg 2 bedroom size in Sunnyvale) | | | Potential fee per 20 unit building (example with all 800 square foot apartments) | | | Potential fee per 100 unit building (example with all 800 square foot apartments) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Option 1 | Option 2 | Option 3 | Option 1 | Option 2 | Option 3 | Option 1 | Option 2 | Option 3 |
| Small Rental In-Lieu Fee | $9.60 | $12.50 | $15.00 | $7,680 | $10,000 | $12,000 | $153,600 | $200,000 | $240,000 | $768,000 | $1,000,000 | $1,200,000 |
| Large Rental In-Lieu Fee | $19.20 | $25.00 | $30.00 | $15,360 | $20,000 | $24,000 | $307,200 | $400,000 | $480,000 | $1,536,000 | $2,000,000 | $2,400,000 |

**Note that the potential fees for a 20 unit and 100 unit building are based on simplified calculations of all units being 800 square feet.*

Using development costs from recent affordable housing developments in Sunnyvale, average unit development costs are nearing $550,000 per unit, not including the cost of land. Table 3 identifies, hypothetically, how each fee option would look if compared on a unit basis, rather than a square footage basis.

Table 3: Fee Example by Inclusionary Unit Requirement*

| Fee Type | In-Lieu Fee per Rental Inclusionary Unit Requirement |
|---|---|
| **Small Project** | |
| Option 1 | $51,200 |
| Option 2 | $66,666 |
| Option 3 | $80,000 |
| **Large Project** | |
| Option 1 | $102,400 |
| Option 2 | $133,333 |
| Option 3 | $160,000 |

**This table assumes a 15% inclusionary requirement with all units being 800 square feet.*

Staff is recommending Option 2 for both small and large projects. This option is within the square footage Nexus Study Fee Range and falls within the range of our neighboring jurisdictions. This In-Lieu Fee rate would cover roughly 25 percent of the typical per unit construction costs seen by our non-profit development partners as they develop affordable housing.

## FISCAL IMPACT

The fiscal impact of creating a new rental housing in-lieu fee would depend on the fee rate and on future levels of new rental housing development. There would be no direct impact to the General

Fund with the adoption of the proposed Ordinance. However, based on the Fee Option adopted by the City Council, the new Rental Housing In-Lieu Fee will increase the amount of revenue generated into the Housing Mitigation Fund (HMF) as all In-Lieu Fees will be deposited into the fund which is used to provide grants and loans to fund the creation of very low and low income affordable units.

## PUBLIC CONTACT

Public contact was made through posting of the Housing and Human Services and Planning Commission agenda, on the City's official-notice bulletin board outside of City Hall, on the City's website, and the availability of the agenda and report in the Office of the City Clerk. Public contact will also be made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website. Interested parties were notified of the hearing dates via email.

## ALTERNATIVES

Recommend to City Council:

**Below Market Rate Rental Housing Ordinance**

1. Introduce an ordinance to add Chapter 19.77 ("Below Market Rate Rental Housing ") to Title 19 ("Zoning") of the Sunnyvale Municipal Code to create Inclusionary Rental Housing Requirements (Attachment 3 to the report).
2. Introduce an ordinance to add Chapter 19.77 ("Below Market Rate Rental Housing ") to Title 19 ("Zoning") of the Sunnyvale Municipal Code to create Inclusionary Rental Housing Requirements, with modifications.
3. Do not introduce an ordinance and provide direction to staff if modifications are desired.

**In-Lieu Fee for Below Market Rate Rental Units**

4. Approve a Resolution to amend the Master Fee Schedule and create a new Small Rental Project In-Lieu Fee of $12.50 per habitable square foot and a new Large Rental Project In-Lieu Fee of $25.00 per habitable square foot, adjusted annually as part of the City Fee Schedule (Attachment 4 to the report).
5. Approve a Resolution to amend the Master Fee Schedule at a different amount than in Alternative 4.
6. Do not create a Rental Housing In-Lieu Fee.
7. Housing and Human Services Commission Recommendation: Approve a Resolution to amend the Master Fee Schedule and create a new Small Rental Project In-Lieu Fee of $15.00 per habitable square foot and a new Large Rental Project In-Lieu Fee of $30.00 per habitable square foot, adjusted annually as part of the City Fee Schedule, and develop a reduced fee for three and four bedroom units to incentivize the provision of units with more bedrooms.

## RECOMMENDATION

Recommend to City Council Alternatives 1 and 4: 1.) Introduce an ordinance to add Chapter 19.77 ("Inclusionary Below Market Rate Rental Housing ") to Title 19 ("Zoning") of the Sunnyvale Municipal Code to create an Inclusionary Rental Housing Program (Attachment 3 to the report); and 2.) Approve a Resolution to amend the Master Fee Schedule and create a new Small Rental Project In-Lieu Fee of $12.50 per habitable square foot and a new Large Rental Project In-Lieu Fee of $25.00 per habitable square foot, adjusted annually as part of the City Fee Schedule (Attachment 4 to the report)

Alternative 1 meets the City goal of increasing affordable rental housing production through an inclusionary housing program for both low and very low income households. Community members attending various outreach meetings voiced support to the City reinstituting rental inclusionary housing at a rate of fifteen percent. In addition, staff recommends Alternative 4 as this option is within the square footage Nexus Study Fee Range and falls within the range of our neighboring jurisdictions. This In-Lieu Fee rate would cover roughly 25 percent of the typical per unit construction costs seen by our non-profit development partners as they develop affordable housing.

As discussed above, Council will have the ability to consider policy or program modifications recommended through the Housing Strategy to modify or improve the inclusionary rental or ownership programs, when the final report is considered in early 2020.

Prepared by: Jenny Carloni, Housing Officer
Reviewed by: Trudi Ryan, Director, Community Development
Reviewed by: Teri Silva, Assistant City Manager
Approved by: Kent Steffens, City Manager

## ATTACHMENTS

1. Reserved for Report to Council
2. Housing Strategy Workshop - Inclusionary Comments Summarized
3. Draft Inclusionary Below Market Rate Rental Housing Ordinance
4. Draft Rental Housing In-Lieu Fee Resolution

**Additional Attachment for Planning Commission Report**

5. Excerpt of Draft Minutes of the Housing and Human Services Commission Meeting of August 28, 2019