File #: 23-0130, **Version:** 1

REPORT TO PLANNING COMMISSION

SUBJECT
Forward Recommendation to City Council to Approve the Non-Residential Housing Mitigation Fee Nexus Study and Adopt a Resolution Amending the Housing Impact Fee for Non-Residential Development (Study Issue) and Find the Actions are Exempt from the California Environmental Quality Act pursuant to CEQA Guidelines Section 15378 (b)(4)

BACKGROUND
The City's housing impact fee for non-residential development, also known as the non-residential Housing Mitigation Fee (HMF), requires new commercial and industrial developments to pay a fee that contributes toward addressing housing needs and improving the jobs-housing ratio in Sunnyvale. The HMF was originally adopted by resolution in 1983 and applied only to projects in industrial-zoned districts that exceeded floor area ratio ("FAR") thresholds (typically 35% FAR) and required City Council approval. In 2002, the HMF was codified and indexed annually to inflation. The HMF was updated again in 2008 and most recently in 2015 when it was expanded to apply to new office, industrial, research and development (R&D), retail, and lodging projects in any zoning district. The current HMF rates for Fiscal Year 2022 are shown below:

Use	Current Housing Mitigation Fees	
Office/R&D/Industrial	First 25,000 net new square feet (SF)	$9.80/SF
	All remaining net new SF	$19.50/SF
Retail/Lodging	All net new SF	$9.80/SF

HMF revenues are collected in the City's Housing Mitigation Fund, which is used to support the development of affordable housing in Sunnyvale. Since the last update to the HMF in 2015, the City has collected over $47 million dollars in housing impact fees.

In February 2021, the City Council approved a study issue (Attachment 2) to review and potentially update the HMF. In order to update a mitigation fee, the California Mitigation Fee Act (Government Code Section 66000 et seq.) requires that local governments determine a reasonable relationship between the impacts of new development, the facilities needed to address those impacts, and the fees that the jurisdiction intends to charge. To meet this requirement, staff selected BAE Urban Economics (BAE) to prepare the Non-Residential Housing Mitigation Fee Nexus Study (Attachment 3).

The Housing and Human Services Commission (HHSC) considered this item on December 14, 2022. The HHSC recommended Alternative 1 and Alternative 4: Adopt a Modified Fee Schedule with Specific Rates for Each Development Type; setting fees for Office/R&D at $15.00 per sq.ft. for first

10,000 sq.ft. and $30.00 for remaining square feet, with no changes to the remaining land uses.

The City Council is scheduled to consider this item on January 24, 2023.

EXISTING POLICY

General Plan, Housing Element, Goal HE-1
Assist in the provision of adequate housing to meet the diverse needs of Sunnyvale's households of all income levels.

Policy HE-1.4 Continue to require office and industrial development to mitigate the demand for affordable housing.

ENVIRONMENTAL REVIEW

The approval of a nexus study and adjustment of fees do not constitute a "project" within the meaning of the California Environmental Quality Act ("CEQA") pursuant to CEQA Guidelines Section 15378 (b)(4) because it constitutes a governmental fiscal activity that does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment.

DISCUSSION

The purpose of the Non-Residential Housing Mitigation Fee Nexus Study is to quantify the relationship between new non-residential development, the increased need for housing for new workers, and the public cost to construct affordable housing for lower-income workers. The underlying assumption of the study is that new non-residential development generates new employment with a range of incomes, including lower-income workers. Based on local household income data and recent development costs, the Nexus Study determines that lower-income worker households will be unable to afford most market-rate housing in Sunnyvale. To mitigate this, the HMF generates revenue from new non-residential development to support the construction of housing that is affordable to lower-income worker households.

The Nexus Study is divided into two primary components: the nexus analysis and the feasibility analysis. The nexus analysis determines the fees that the City would need to charge to support the construction of affordable units for new lower-income worker households. These are the maximum legal fees that could be charged and are typically much higher than can feasibly be supported by new non-residential development. To address this discrepancy, the Nexus Study also includes a feasibility analysis to determine the financial impact that new fees could have on non-residential development as well as a comparison of fees in neighboring jurisdictions.

Nexus Analysis

The nexus analysis determines the maximum legal fee for four common non-residential land uses in Sunnyvale: office/R&D, retail/restaurant, hotel, and industrial/warehouse. In order to calculate the maximum legal fee, the nexus analysis estimates the number of new worker households by income level per square foot for each land use category. The analysis then determines the financing gap for an affordable unit based on estimated development costs for recent affordable projects in Sunnyvale. The maximum legal fee per square foot is then determined by multiplying the number of lower-income worker households per square foot by the financing gap to develop an affordable unit. A summary of the nexus analysis is shown in the table below:

Land Use Category	Lower-Income Worker Households Per 1,000 Square Feet (SF)	Maximum Legal Fee Per SF
Office/R&D	0.32	**$104.15**
Retail/Restaurant	0.57	**$189.74**
Hotel	0.17	**$58.10**
Industrial/Warehouse	0.12	**$35.37**

Feasibility Analysis

The next step of the Nexus Study is to determine the financial feasibility of the maximum legal fee on non-residential development. A comparison of fees throughout the region can help determine if higher fees in Sunnyvale would be financially feasible for new development or if lower fees in neighboring cities may be more attractive to developers. BAE surveyed eight neighboring jurisdictions to compare non-residential housing mitigation fees in the region. Housing mitigation fees in the region vary considerably both in amount and by land use category. In general, Sunnyvale's current HMF structure is well within the range of fees charged by neighboring cities. The City's current fees for office/R&D development are slightly lower than most neighboring cities, but retail and hotel fees are slightly higher. The City's industrial fee rates are comparable to other jurisdictions, but several cities do not include industrial as a specific category. In all cases, fees throughout the region are much lower than the maximum legal fees determined by the nexus analysis. A full comparison of fee rates throughout the regions is shown in Table 9 on page 22 of the Nexus Study (Attachment 3).

In addition to the fee comparison, the study tests the feasibility of current and increased fee rates on non-residential development prototypes. BAE created five development prototypes based on information gathered from developers and recent and anticipated developments in Sunnyvale. Prototypes include a mid-size 4-story office and a larger 8-story office/R&D development, as well as retail, hotel, and industrial developments. BAE analyzed each prototype's financial pro formas under different HMF fee structures. This analysis determined that both office/R&D prototypes are financially feasible under current HMF rates and would be able to support a fee increase. However, retail, hotel, and industrial developments face feasibility challenges under the current fee structure and do not support a fee increase at this time.

Developer Outreach

As part of the Nexus Study, BAE conducted one-on-one interviews with non-residential developers and held a focus group to gather input from stakeholders. Developers did not indicate that the City's current HMF rates imposed a significant constraint on non-residential development. Developers did state that they prefer a gradual fee increase, advance notice of a fee increase, and consideration for alternative compliance measures, such as including affordable units within mixed-use projects. More generally, developers cited wide-ranging development challenges related to high construction costs, unprofitability of new retail development, and uncertainty about demand for new office development.

Study Recommendations

Based on the results of the feasibility analysis, the study supports the following three recommendations:

1. The City's current HMF rates for retail, lodging, and industrial uses should not be changed. The financial pro forma analysis shows that each of these uses face feasibility challenges under the current fee structure. Additionally, Sunnyvale's fees for these categories are

generally higher than many nearby jurisdictions.

2. The City should increase the HMF rate for Office/R&D development up to a maximum of $11 per square foot for the first 25,000 square feet and $22 per square foot for all remaining square feet. This would increase the current Office/R&D fee rates by approximately 13%. The study determines that these fee rates would have little overall effect on development feasibility, amounting to 1% of total development costs (excluding land) for the first 25,000 square feet and 2% of total development costs (excluding land) for all remaining square feet. These fees would also fall well within the range of fees charged by neighboring cities.
3. The City should consider potential strategies to make fee increases more feasible, including phased increases, discounts for projects that pay prevailing wages, and alternative compliance options for mixed-use developments that incorporate affordable units in the project.

A summary of the Nexus Study conclusions and recommendations is shown in the table below:

Use Type	Maximum Legal Fee	Current Fee Rate	Feasibility (with no change in fee)	*Maximum Recommended Fee Rate*
Office/R&D	$104.15	$9.80 for first 25,000 SF $19.50 for remaining SF	Marginal	*$11 for first 25,000 SF* *$22 for remaining SF*
Retail/ Restaurant	$189.74	$9.80	Not Feasible	*No Change*
Lodging	$58.10	$9.80	Not Feasible	*No Change*
Industrial/ Warehouse	$35.37	$9.80 for first 25,000 SF $19.50 for remaining SF	Not Feasible	*No Change*

Staff Recommended Fee Structure

Based on the analysis and recommendations of the Nexus Study, Staff recommends increasing the fee rate for office/R&D development to $11 per square foot for the first 25,000 square feet and $22 per square foot for all remaining square feet. Staff also recommends to not change the fee rates for retail/restaurant, lodging, and industrial developments. All HMF fees will remain indexed to inflation (i.e., Consumer Price Index for all urban consumers in the San Francisco-Oakland-San Jose area). Staff recommends that Council adopt a resolution (Attachment 4) to amend the Master Fee Schedule with the recommended fee structure. This fee structure will help the City meet affordable housing needs, while minimizing constraints for non-residential development. This is especially important to support new retail development, which faces significant financial feasibility challenges.

Staff also considered potential strategies to make fee changes more feasible, such as phasing the fee change over several years. However, due to the relatively modest increase to the office/R&D fee, a phasing approach is not recommended. Sunnyvale Municipal Code Section 19.75.020 (adopted in 2015), which is entitled “General applicability,” includes two provisions relevant to the 2015 fee structure. The first provision relates to pipeline projects:

(b) Pipeline Projects. The following development projects shall be exempt from payment of the housing impact fees required in this chapter:

(1) Projects for which a development application pursuant to this title has been

filed and deemed complete by September 14, 2015.

(2) Projects that have received final approval pursuant to this title by September 14, 2015, and which are subsequently the subject of a pending application for modifications to the approved plans or permit, except that any increase in floor area from the amount already approved shall be subject to the housing impact fees required by this chapter.

(3) Pipeline projects not subject to the new housing impact fees must pay any applicable housing mitigation fees that were in existence at the time the application was deemed complete.

The second provision relates to Calculation and Timing of Payment which states that:

(d) Calculation and Timing of Payment. Housing impact fees shall be calculated at the time of complete building permit application submittal and shall be paid prior to issuance of the first building permit for the project . . .

Staff is aware of only one legacy project that was filed and deemed complete prior to September 14, 2015. This project is subject to the legacy HMF rate of $13.00 per square foot, in contrast with the $19.50 per square foot for other newer developments. In order to increase the HMF for the one legacy development, the Zoning Code would need to be modified.

Pursuant to State law, development-related fees take effect no sooner than 60 days after Council adoption (i.e., March 25, 2023). The Council could either consider an additional increase with adoption of the FY 2022/23 Fee Schedule in June 2023, which would take effect in August 2023, or determine not to increase the fee for next fiscal year. Alternatively, the Council could phase in the current recommended increase with 50% now and 50% considered with the FY 2023/24 budget fee schedule.

Staff also considered discounts for projects that pay prevailing wage, but this consideration would require increased Staff resources needed for monitoring. The City of San Mateo provides a reduction in the housing impact fee if the developer pays prevailing wage during construction. This provision would benefit construction workers during construction, but would not expand the supply of affordable housing and is not recommended.

Additionally, it should be noted that Council may approve an alternative compliance option for the HMF at the developer's request on a project-by-project basis in accordance with the City's Below Market Rate Inclusionary regulations (SMC Section 19.77.100).

FISCAL IMPACT

The fiscal impact of an adjustment of HMF rates would depend on the fee rate and future levels of development subject to the fee. Alternative 3 would increase the current fee rate for Office/R&D development by approximately 13%, but the fee rate for other land use categories would remain unchanged. Projecting actual increases to the HMF are difficult as revenue fluctuates with economic changes, land use changes, and new development opportunities. Staff anticipates significant new revenue to come from future office development built in the Moffett Park Specific Plan (after adoption of the plan update) over the next 20 years. The Nexus Study determines that Alternative 3 would not negatively affect the feasibility of non-residential development. However, if fees are increased beyond this rate, there may be impacts on project feasibility, which in turn could have a negative impact on the General Fund and other funds supported by development fees, including the Housing Mitigation Fund.

PUBLIC CONTACT

Public contact was made through posting of the Housing and Human Services 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 Planning Commission and 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. The draft Non-Residential Housing Mitigation Fee Nexus Study was posted on the City's website. Interested parties were notified of hearing dates via email.

ALTERNATIVES

Recommend that the City Council:

Non-Residential Housing Mitigation Fee Nexus Study:

1. Approve the Non-Residential Housing Mitigation Fee Nexus Study.
2. Do Not Approve the Non-Residential Housing Mitigation Fee Nexus Study.

Fee Schedule:

3. Adopt a Resolution Amending the Housing Impact Fee for Non-Residential Development for Office/R&D Development to Increase the Fee to $11 per Square Foot for the First 25,000 Square Feet and $22 per Square Foot for All Remaining Square Feet, Adjusted Annually for Inflation, with No Changes to the Fee Schedule for Retail, Lodging, and Industrial.
4. Adopt a Modified Fee Schedule with Specific Rates for Each Development Type as Directed by Council.
5. Do not Modify any Fees and Provide Other Direction to Staff Regarding Housing Mitigation Fees.

RECOMMENDATION

Alternatives 1 and 3: Recommend that the City Council Approve the Non-Residential Housing Mitigation Fee Nexus Study and Adopt a Resolution Amending the Housing Impact Fee for Non-Residential Development for Office/R&D Development to Increase the Fee to $11 per Square Foot for the First 25,000 Square Feet and $22 per Square Foot for All Remaining Square Feet, Adjusted Annually for Inflation, with No Changes to the Fee Schedule for Retail, Lodging, and Industrial.

Alternative 1 provides the justification for a modification of the HMF structure, as required by State law. The Nexus Study clearly determines a relationship between the impact of new non-residential development, the need for new affordable housing, and the new fee structure that will help address this need. Furthermore, the Nexus Study includes an in-depth financial feasibility analysis based on local data and developer interviews to determine the appropriate fee rate for non-residential development.

Alternative 3 establishes a fee structure that will help the City meet the need for new affordable housing. The recommended fee structure will provide an overall increase in Housing Mitigation funds but will allow fee rates to remain well within the range of neighboring jurisdictions. Additionally, by recommending a modest fee increase only for office/R&D development, the new fee structure will not add further feasibility constraints to hotel and retail development, a critical tax revenue source for the City.

Prepared by: Ryan Dyson, Housing Specialist
Reviewed 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. City Council Study Issue CDD 21-02
3. Non-Residential Housing Mitigation Fee Nexus Study
4. Draft Resolution