

Agenda Report

August 27, 2018

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: William K. Huang, Director of Housing and Career Services

**SUBJECT: PUBLIC HEARING: PROPOSED ADJUSTMENTS TO INCLUSIONARY
IN-LIEU FEE RATES**

RECOMMENDATION:

It is recommended that upon the close of the public hearing, the City Council take the following actions:

- 1) Find that the recommended action is exempt from the California Environmental Quality Act ("CEQA") pursuant to State CEQA Guidelines per Section 15061 (b) (3), the General Rule that CEQA only applies to projects that may have an effect on the environment; and
- 2) Approve the recommended Inclusionary In-Lieu Fee rates shown in the table below and the implementation schedule as described in this report.

EXECUTIVE SUMMARY

The table below summarizes the current FY 2019 Adopted In-Lieu Fee rates, the recommended In-Lieu Fee rates, and the percentage change between the rates.

| Project Type and Sub-Area | FY 2019 Adopted In-Lieu Fee Rate (\$/sq ft) | FY 2019 Recommended In-Lieu Fee Rate (\$/sq ft) | Percent Change |
|----------------------------------|--|--|-----------------------|
| 10-49 Rental Units | | | |
| Sub-area A | Determined on a case-by case basis | 50.92 | Not applicable |
| Sub-area B | 1.23 | 33.87 | 2653% |
| Sub-area C | 27.46 | 35.28 | 28% |
| Sub-area D | 24.97 | 50.92 | 82% |
| 50+ Rental Units | | | |
| Sub-area A | Determined on a case-by case basis | 70.72 | Not applicable |
| Sub-area B | 1.23 | 47.03 | 3723% |
| Sub-area C | 37.47 | 48.99 | 31% |
| Sub-area D | 34.98 | 70.72 | 102% |
| 10-49 For-Sale Units | | | |
| Sub-area A | 47.45 | 52.43 | 10% |
| Sub-area B | 17.47 | 31.10 | 78% |
| Sub-area C | 28.72 | 32.24 | 12% |
| Sub-area D | 22.47 | 52.43 | 133% |
| 50+ For-Sale Units | | | |
| Sub-area A | 66.20 | 72.82 | 10% |
| Sub-area B | 23.72 | 43.19 | 82% |
| Sub-area C | 39.96 | 44.78 | 12% |
| Sub-area D | 31.22 | 72.82 | 133% |

BACKGROUND:

The City's Inclusionary Housing ordinance was enacted in 2001 and codified as "Inclusionary Housing Requirements" in Chapter 17.42 of the Zoning Code. The ordinance applies to new housing developments of ten or more units. For rental developments, the ordinance requires that 10% of the units permitted to be built under the current zoning of the development site (the "base density") are to be restricted as affordable housing at the Low income level, and 5% at the Moderate income level. For for-sale developments, 15% of the base density units are required to be restricted at the

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Moderate income level. Developers may provide a smaller percentage of affordable units if the restricted units are at a deeper affordability level (e.g., one Very Low income unit instead of two Moderate income units). Recorded deed restrictions protect the long-term affordability of the Inclusionary units: 45 years for for-sale inclusionary units and in perpetuity for rental inclusionary units.

The City provides certain incentives for developers to produce affordable inclusionary units:

- Residential Impact Fee discount (e.g., \$991 vs. \$22,435 for a 2-bedroom unit)
- Building Permit Fee - partial waiver
- Traffic Impact Fee – waived for each affordable unit

A total of 533 affordable units have been produced under the inclusionary ordinance to date. Most of these units have been built outside of Northwest Pasadena, thereby helping to geographically distribute affordable housing, many in Transit Oriented Districts.

| | Very Low Income | Low Income | Moderate Income | Total Affordable | Market Rate | Total Units |
|--------------------------|------------------------|-------------------|------------------------|-------------------------|--------------------|--------------------|
| Rental | 152 | 68 | 266 | 486* | 1,734 | 2,220 |
| For-Sale | 7 | 2 | 38 | 47 | 240 | 287 |
| TOTAL | 159 | 70 | 304 | 533 | 1,974 | 2,507 |
| % Total Affordable units | 30% | 13% | 57% | 100% | | |

*169 units are Fuller student housing 18 Low Inclusionary, 9 Mod Inclusionary, 142 Mod Affordable

Alternatives to Providing Inclusionary Units On-Site

The City's ordinance provides developers with three alternatives to providing affordable units on-site within a proposed project that is subject to the Inclusionary ordinance:

- Provide the inclusionary units at another property ("off-site" units)
- Pay the Inclusionary In-Lieu Fee
- Donate land at a value equal to (or greater than) the In-Lieu Fee amount

The In-Lieu Fee is the option most often exercised by developers of for-sale condominium projects. In-Lieu fee payments are deposited into the Inclusionary Housing Trust Fund. As of end of FY 2018, approximately \$21.9 million have been generated from In-Lieu fee revenues. Inclusionary Housing funds have been used by the City to support a wide range of affordable housing activities. A total of 691 affordable units (not including the 533 Inclusionary units developed) have been assisted consisting of new production projects (176 units) and rehabilitation/affordability preservation projects (515 units). Projects that have been completed in recent years with Inclusionary funds include Heritage Square (70 units for seniors), Marv's Place (20 units of permanent supportive housing for homeless families), Hudson Oaks (44 units

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for seniors), and Washington Classics (6 homeownership units within a project that eliminated a liquor store blight). The current uncommitted balance of the Inclusionary Fund is approximately \$3 million. Ten percent of Inclusionary monies are allowed to be expended on program administration.

A critically important piece of legislation for local governments in California addressing the affordable housing crisis was signed into law on September 29, 2017. AB 1505 (the "Palmer Fix") restored the authority of cities and counties to require the inclusion of affordable housing in new rental housing projects (local governments can already apply inclusionary policies on for-sale housing). AB 1505 also requires cities and counties to provide for alternate means of inclusionary compliance that may include land dedication, off-site construction or rehabilitation of affordable units, and in-lieu fees.

In-Lieu Fee and Synopsis of Consultant Analysis

As indicated above, developers may comply with the City's Inclusionary requirements by paying the In-Lieu Fee, which is typically done at the time the building permit is pulled (developers also have the option, at an additional 10% cost, to make equal installment payments at building permit and certificate of occupancy).

The determination of the In-Lieu Fee amount for a given Inclusionary project is based on the total number of units in the project, the net residential floor area (sq. ft.) of those units, the project's Inclusionary Sub-Area location (see Inclusionary Sub-Area Maps, Attachment A), and the applicable In-Lieu Fee rate. The boundaries of the Inclusionary Sub-Areas reflect geographic areas which have similarities in local housing market conditions and therefore, result in differences in the applicable In-Lieu Fee rate and, ultimately, the amount of the fee itself. The In-Lieu Fee rate schedule is set forth in section 17.42.050 of the City's Schedule of Taxes, Fees and Charges.

Example of an In-Lieu Fee calculation:

The project is a 35-unit rental development with a net residential floor area of 42,000 sq. ft., located in Inclusionary Sub-Area D. The applicable In-Lieu Fee rate is \$24.97 per sq. ft. The In-Lieu Fee is calculated by multiplying the net residential floor area (42,000 sq. ft.) by the In-Lieu Fee rate (\$24.97/sq. ft.). Hence, the Inclusionary In-Lieu Fee for this project is \$1,048,740.

The In-Lieu Fee rates are subject to annual increases per the rate of change in the Consumer Price Index ("CPI"). However, CPI changes are not necessarily reflective of the housing market. The Inclusionary ordinance provides for periodic analysis of the In-Lieu Fee rate structure to reflect changes in the housing market. The rate structure was last modified in 2005 (other than annual CPI adjustments).

Recently, under a City contract, housing financial consultant David Paul Rosen & Associates ("DRA") commenced an analysis of the City's Inclusionary In-Lieu Fee structure with the purpose of updating the fee rates to reflect current housing market conditions in Pasadena.

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DRA's calculation of the updated In-Lieu Fee rates is derived from an affordability gap analysis that considers the differential between market prices of new housing units and the prices that Low and Moderate income households can afford to pay. DRA's methodology includes analyzing the eight Inclusionary Sub-Areas (four rental housing and four for-sale housing sub-areas) to account for geographic variances in market housing prices. These Sub-Areas subdivide the Pasadena housing market into respective geographic areas based on similarities and variations in housing market characteristics.

Using information gathered from a market survey of recently built and proposed projects in Pasadena, DRA formulated housing development prototypes for rental and condominium projects. The prototypes serve to establish typical unit sizes and bedroom mixes for rental and condominium developments. DRA reviewed market price data for new rental and condominium developments in order to establish market rents and sale prices for each Sub-Area. A comparison was then conducted between market rents/sales prices and affordable rents/sales prices. From this comparison, DRA quantified the rental and condominium affordability gaps for each Sub-Area, which in turn formed the basis for the In-Lieu Fees for each housing type in each Sub-Area.

The table listed above compares the FY 2019 Adopted In-Lieu Fee rates with the rates supported by the DRA study (updated as of August 13, 2018). As shown, the adjusted In-Lieu Fee rates determined by DRA's analysis represent, without exception, an increase from the existing rates for all project types, throughout all Sub-areas. In a few cases the rates increased very markedly. In particular, the percent change in the In-Lieu Fee rates for rental projects in Sub-Area B (which is within northwest Pasadena) is 2653% for 10- to 49-unit projects and 3723% for projects with 50 or more units. This is due principally to increases in housing market values that have occurred over the past 13 years, in addition to some methodological differences between the analysis performed by DRA and the market study done in 2005. Also, the 2005 study did not establish in-lieu fee rates for rental projects in Sub-area A because case study data were not available for this category of projects. Such data was available for the current DRA study, resulting in recommended in-lieu fee rates.

An initial draft report of DRA's study was completed in March 2016 and posted on the Housing Department's website. A community housing workshop was held on April 12, 2016 which focused on the Inclusionary Housing ordinance and the In-Lieu Fee study. A number of market rate multifamily developers were in attendance. The draft report was updated in April 2017 and August 2018, and is provided in Attachment B.

Comparison with Other Cities' Inclusionary Policies

Staff compared the City's In-Lieu Fees with nine (9) other local inclusionary housing programs which also provide an in-lieu fee option to developers. The results are summarized in the table below. Each city utilizes a different methodology to determine their fees, and the amounts are dependent on local variables including market housing values, area median income, and local construction costs. Hence, the in-lieu fee amounts shown do not represent an "apples to apples" comparison. With this caveat in mind, the following observations can be made:

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- Rental project in-lieu fee: Pasadena's fee is slightly greater than the average of the cities that provide such a fee option. All things being equal, a developer that chose to build a rental project in Pasadena would have a slight incentive to provide the Inclusionary units rather than pay the In-Lieu Fee.
- For-Sale project in-lieu fee: Pasadena's fee is significantly lower than the average of the cities that provide such a fee option. All things being equal, a developer that chose to build a for-sale project in Pasadena would have a greater incentive to pay the In-Lieu Fee rather than provide the Inclusionary units. However, with the proposed hike in this fee rate (133% for Sub-area D), the Pasadena For-Sale fee would be greater than all of the other cities with the exception of Berkeley.
- The apparent contrast between the Pasadena Rental and For-Sale fees in relation to the all-cities averages can be attributed to a number of factors including the Pasadena Sub-area D Rental fee rates being higher than Pasadena Sub-area D For-Sale rates; and wide variances in methodologies and assumptions used by cities to calculate their in-lieu fees.

| City | Inclusionary Requirement (% of project units) | In-Lieu Fee Rental 35-unit project | In-Lieu Fee For-Sale 35-unit project |
|---|--|---|---|
| Berkeley | 20% | \$1,190,000 | \$3,831,522 |
| Brea | 10% (for-sale only) | Not applicable | \$814,726 |
| Huntington Beach | 10% (for-sale only) | Not applicable | \$1,543,968 (30-unit project) |
| Irvine | 15% | \$584,255 | \$534,176 |
| Pasadena (sample project: Sub-Area D 42,000 sf) | 15% | Current: \$1,048,740 (Proposed: \$2,138,640) | Current: \$943,740 (Proposed: \$2,202,060) |
| Richmond | 10% to 17% | \$377,790 | \$413,770 |
| San Bruno | 15% | \$1,382,500 | \$1,238,400 |
| San Jose | 15% (for-sale only) | Not applicable | \$981,926 |
| Santa Monica | 5% to 25% | \$1,359,960 | \$1,739,720 |
| West Hollywood | 20% to 30% | No fee option for projects > than 10 units | No fee option for projects > than 10 units |
| | Current Average: | \$990,540 | \$1,337,994 |

Inclusionary In-Lieu Fee and Cost of Development in Pasadena

The DRA study concludes that increases are economically justifiable for In-Lieu Fee rates across the board. A higher fee will incentivize developers to provide affordable units, which is the intent of the Inclusionary ordinance, instead of paying the fee. Historically, most of the In-Lieu Fee payments have been made from for-sale housing projects for which the Inclusionary ordinance requires affordable moderate income units. Arguably, the In-Lieu Fee generated from a luxury condominium project is of greater "value" from a City housing needs perspective, as the funds can be used to

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subsidize rental housing production or preservation at deeper levels of affordability (i.e., very low and low income), for which the need is greater, and for a much longer period – for-sale units are deed-restricted for 45 years vs. affordable rental housing in perpetuity.

Staff recognizes that any change to the City's Inclusionary fee needs to be viewed within the broader context of the cost to develop projects in Pasadena and the effect of the inclusionary in-lieu fee on private residential development activity. The cost of local development fees in Pasadena are generally regarded to be among the highest in Southern California. For example, the City's Residential Impact Fee to build a 3-bedroom unit is nearly \$24,900 compared to the City of Glendale's Quimby Act fee (to fund parks and recreational purposes) which averages \$18,400 per unit. In spite of the relative costs of developing in Pasadena, residential activity remains high.

Fees paid by developers at City building permit issuance for new residential projects include Residential Impact, Construction Tax, Transportation Improvement, PUSD Residential Development, Plan Checks, Sewer Facility Charge, and Building Permit. Many of these fees are used to cover the City's cost of maintaining adequate levels of public services, infrastructure and amenities. However, it should be emphasized that the Inclusionary fee does not represent a development impact fee or a linkage fee. Payment of the fee is an option under the Inclusionary housing ordinance that is available to developers in-lieu of providing the affordable housing units pursuant to the zoning code. Had these projects provided Inclusionary units on-site, no In-Lieu Fees would have been payable and the projects would have received affordable housing incentive reductions for a number of fees, including the Residential Impact Fee and the Transportation Improvement Fee.

For this reason, the extent to which an increase in the Inclusionary fee may impact privately financed residential development activity is essentially a question of the degree to which the City's inclusionary housing requirement hinders private development. In the post-Great Recession period, Pasadena has experienced a high level of residential development activity, drawn by some of the highest housing rents and sale prices in the region. It does not appear that the City's Inclusionary zoning ordinance has had a dampening effect on residential development.

Proposed Increase to In-Lieu Fee Rates and Implementation Schedule

Staff recommends approval of the full increase in fee rates supported by the DRA study. The City's Adopted FY 2019 Schedule of Taxes, Fees and Charges would be amended to incorporate the adjusted In-Lieu Fee rates, and that the amended rates shall become effective 60 days upon their approval by City Council. Furthermore, the current adopted FY 2019 rates will remain applicable to Inclusionary projects for which an application for a required discretionary action (e.g., Hearing Officer approval, Concept Design Review approval by the Design Commission) is submitted on or prior to December 31, 2018. All other projects would be subject to the amended (increased) FY 2019 In-Lieu Fee rates.

One option that may be considered is a phase-in implementation of the In-Lieu Fee rate increases where only 50% of the recommended fee rate increases is applied in FY 2019 and the remaining 50% is applied thereafter. Potential impacts of the proposed phase-in include: reduced financial impact on developers whose projects that will be processed

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for entitlements during the phase-in period; foregone Inclusionary In-Lieu Fee revenues to the City; and fewer Inclusionary units produced (as some developers may be incentivized to take advantage of the 50% reduced fees during the phase-in period).

COUNCIL POLICY CONSIDERATION:

This proposed action supports the City Council Strategic Planning Three-Year Goals in the areas of promoting the quality of life and the local economy.

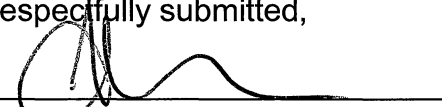
ENVIRONMENTAL ANALYSIS:

The action proposed herein is exempt from the California Environmental Quality Act (CEQA), pursuant to State CEQA Guidelines Section 15061 (b)(3), the "General Rule" provision of CEQA which applies to projects which may have the potential for causing a significant effect on the environment. Where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the activity is not subject to CEQA. The approval of the proposed changes to the Inclusionary Housing program will not have a significant effect on the environment and, therefore, are not subject to CEQA.

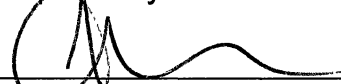
FISCAL IMPACT:

Approval of the staff recommendations will result in increased fee amounts to be paid by residential project developers that elect the Inclusionary In-Lieu Fee option to satisfy the City's Inclusionary housing ordinance. However, given the varying types, sizes, and locations of Inclusionary projects that are processed through the City's entitlement system, and the fact that the developer's commitment to make an In-Lieu Fee payment is oftentimes not finalized until near the end of the entitlement process, it is not possible to provide a reliable projection of the amount of annual In-Lieu Fee payment revenues into the City's Inclusionary Housing Trust Fund as a result of the proposed action. As the proposed action pertains only to Inclusionary housing revenues, there will be no direct fiscal impact on the City's General Fund.

Respectfully submitted,


for WILLIAM K. HUANG
Director of Housing and Career Services

Prepared by:


James Wong
Senior Project Manager

Approved by:


STEVE MERMELL
City Manager

Attachments:

- A – Inclusionary Sub-Area Maps
- B -- In-Lieu Fee study