



ECONOMIC VITALITY COMMITTEE REPORT

October 17, 2024
Community Development

TITLE: CITYWIDE DEVELOPMENT IMPACT FEES, AFFORDABLE HOUSING FEE, SEWER AND WATER CONNECTION FEES, AND INCLUSIONARY ZONING ORDINANCE UPDATE

SUMMARY

Staff and a professional services team are undertaking work to update the City's Development Impact Fees and Sewer and Water Connection Fees. These one-time fees are charged to new development to help address the costs of new and expanded facilities and infrastructure to meet the demands of residential and commercial growth. Concurrently, the City is updating the Inclusionary Zoning Ordinance (IZO) and related Affordable Housing Fee, which are in place to address the community's need for affordable housing that comes with new development. State law and best practice demand that these sorts of fees be studied and re-examined on a regular basis to ensure that they are being charged at an appropriate level.

Following an extensive study process since early 2024, including three workshops with City Council to report initial analysis and receive feedback on the fee and IZO updates, staff is preparing to bring the final reports and studies to the City Council for a recommendation on adoption of fees, and amendments to the IZO by the end of 2024. This report updates the Economic Vitality Committee on the work to date, and provides an opportunity for comments and questions, prior to consideration by City Council.

RECOMMENDATION

Receive report from staff on updates to Development Impact Fees, Affordable Housing Fee and Inclusionary Zoning Ordinance.

BACKGROUND

Development Impact Fees and Sewer and Water Connection Fees

Pleasanton, like almost all local jurisdictions, levies a variety of fees on new development, including a Transportation Impact Fee (TIF) and Capital Facilities Fee (CFF), which help offset the impacts of that new development on City infrastructure and facilities. Separately, the City charges connection fees for projects that create new connections to and demands on the municipal sewer and water network, and which similarly address the physical improvements necessary to serve that demand. The City's TIF and CFF were last updated in 2018, the Sewer Connection fee was last updated in 2008, and the Water Connection Fee updates last updated more than 30 years ago, in 1992.

State law, under AB 1600, also known as the Mitigation Fee Act, establishes strict requirements for establishing impact fees to ensure that there is an appropriate relationship, or “nexus” between the fees charged to new development and its impacts. State law and best practice also require fees to be updated regularly, typically every five to eight years. This documentation is provided in the form of a Nexus Study, which includes the necessary data and analysis to demonstrate the relationship between fees charges and the costs of the new infrastructure and facilities they will support. Pursuant to AB 1600, fees cannot be imposed on new development to correct existing deficiencies or meet pre-existing needs. And, impact fees may only be used for capital and related expenses for the construction or expansion of facilities – they cannot be used to pay for ongoing maintenance or operational costs.

Affordable Housing: Inclusionary Zoning Ordinance and Affordable Housing Fees

The City adopted the Inclusionary Zoning Ordinance (IZO) in 2000, and has not updated the Ordinance since then. The IZO includes requirements for larger residential projects to build or “include” affordable housing units on-site as part of their development, with projects required to provide between 15 and 20 percent of total units at rental or sales prices that are affordable to low and/or moderate-income households. Since 2000, the IZO has resulted in the production of hundreds of units of affordable housing, benefitting many lower-income households in Pleasanton and contributing to the current inventory of over 1,200 affordable units. While providing these units comes at a cost to new development, it has significant community and economic benefit in providing housing for the local workforce, meeting equity goals, and ensuring access to the high quality of life that Pleasanton enjoys, for all segments of the community.

Despite the success of the IZO in supporting production of affordable housing, update to the Ordinance is needed. The Ordinance relies on relatively broad and flexible standards that the City was previously able to use to negotiate project-specific agreements regarding affordable housing. However, recent changes in State law significantly limit local discretion and do not allow the application of non-objective standards, which has reduced the City’s ability to effectively enforce the IZO’s requirements.

In addition to these improvements, at the request of City Council, the update provides an opportunity to review/revisit the percentage of required on-site affordable units required by the IZO (the “inclusionary rate”), and to consider other aspects such as the target affordability of required units, to ensure they are meeting community needs and housing and other policy goals.

Related to the IZO, Pleasanton has had an Affordable Housing Fee in place since 1990. This fee is paid by commercial development; by smaller residential projects not subject to requirements to build on-site affordable housing; and by projects approved to pay the fee “in-lieu” of otherwise required on-site units to mitigate their effect on demand for affordable housing units. The recent fee studies include evaluation of changes to this fee, with a particular interest from the Council in trying to set the fee at a level more equivalent to the cost of the subsidy necessary to construct and provide affordable units

at a below-market cost – doing so will incentivize builders to create units rather than requesting to “fee out” of the inclusionary requirement, which occurs when fees are substantially less than the cost to build.

DISCUSSION

Work to update the various impact fees, affordable housing fee and IZO has been underway since early 2024 by City staff with a professional services firm, Economic and Planning Systems (EPS). Update to the City’s water and sewer connection fee has been supported by professional services firm Raftelis, Inc.

City Council Input and Direction to Date

To date, three study sessions have been held with City Council to consider various aspects of the impact fee and IZO update:

May 7, 2024 Workshop

On May 7, 2024, staff held an introductory workshop with City Council to discuss the results of EPS’ and Raftelis’ initial analysis, including initial findings and recommendations with respect to impact fees more generally, and an evaluation of potential changes to the inclusionary rate. ¹

With respect to impact fees, the analysis generally found that new growth and the cost of infrastructure and facilities to serve it could justify significantly higher impact fees. However, the report notes there are tradeoffs to be considered – in particular, setting fees at a very high level could have the negative consequence of discouraging, or making infeasible, new development or investment in the city – which could have longer-term fiscal impacts.

With respect to housing fees, the EPS analysis evaluated various inclusionary rate scenarios, including scenarios that would increase the current inclusionary rate and others that would retain or reduce it. EPS also looked at the resultant equivalent in-lieu fee, if set at a level reflecting the equivalent cost to construct, as well as the overall feasibility of setting fees at those rates.

Based on the analysis, it was staff’s initial recommendation to set in-lieu fees for all types of projects at 15% (i.e., decrease the current single-family/ownership rate and retain the existing multi-family rate). The report noted that the current market is extremely challenging for multi-family projects, and so increasing either the rate or the in-lieu fee could further impact the feasibility of multi-family development – thus an increase in the inclusionary rate is unlikely to be feasible in the near term.

August 20, 2024 Workshop

¹ Link to May 7, 2024 Agenda Item and Attachments:
<https://weblink.cityofpleasantonca.gov/WebLink/0/doc/308907/Page1.aspx>

The City Council held a follow-up workshop on August 20, focused on the Inclusionary Zoning Ordinance.² At this meeting, EPS provided additional analysis and refined scenarios for the inclusionary rate and in-lieu affordable housing fee. Staff also provided information and analysis and requested direction on several key policy questions regarding the content of the IZO. A majority of the City Council provided consensus direction on these items, including a recommendation to reduce the current inclusionary rate from 20% to 15% for single-family ownership residential development, the same as multi-family/rental development.

October 15, 2024 Workshop

On October 15, the City Council reviewed the draft updated IZO based on their feedback at the August 20 meeting, and on a recommendation by the Planning Commission. (Due to the timing of this EVC meeting, outcomes of the City Council meeting will be reported verbally to the EVC).

Impact Fee Studies

While work is continuing to finalize the fee studies, the consultant has developed estimates of the updated fee amounts, provided in the various tables on the following pages. It is important to note that the studies, and each of the tables identifies and calculates the maximum fee amount that can be justified based on the analysis. It is then a policy decision of the City Council to decide on the level at which those fees are set, which may be at or below the maximum. It is noted that in May, 2024, staff provided initial estimated fee amounts to help inform City Council discussion at that time; since then, the Fee Study has progressed and its inputs and variables refined, such that numbers provided below differ to some degree from those initial estimates.

As described above, a key point in the early analysis was to consider the aspect of financial feasibility – if fees are set at a level substantially above the costs that new development can support, then it may discourage or impede economic development that will contribute longer term revenues in the form of property tax and sales tax. Conversely, if fees are set too low, then it may impact the City’s ability to pay for infrastructure and facilities upgrades to keep pace with new development.

Capital Facilities and Transportation Impact Fee Estimates

The following methodology and assumptions are used to calculate the CFF and DIF, including the following basic steps

- Estimates of projected future population and employment growth – combined to create an estimated future service population” of residents and employees. EPS estimates the service population growth, as a percentage of total service population, will grow by approximately 22.7%.

² Link to August 20, 2024 City Council Agenda Item and Attachments:
<https://weblink.cityofpleasantonca.gov/WebLink/0/doc/309074/Page1.aspx>

- Evaluation of the necessary infrastructure and capital improvements to serve the future service population, exclusive of water and sewer improvements that are part of a separate fee study (see below).
- Cost estimates of these infrastructure and capital improvements, based on information provided by City staff and other research.
- The allocation of costs between existing and future development, and between residential and commercial uses to derive a cost per resident and per employee
- Multiplication of those costs per resident or employee, by the future service population.

Table 1: Capital Facilities and Transportation Fee, Maximum Amounts¹

Land Use	Capital Facilities Fee	Transportation Impact Fee	Total Maximum Fee	Current Fee Amount
Residential (per unit)				
Single-Family	\$29,095	\$20,162	\$49,257	\$32,122
Multi-Family	\$20,604	\$10,939	\$31,543	\$21,751
Non-Residential (per square foot)				
Office	\$13.41	\$31.50	\$44.91	\$21.14
Retail	\$9.15	\$48.35	\$57.50	\$28.87
Industrial	\$4.02	\$17.94	\$21.96	\$11.94
Lodging	\$1.34	\$25.82	\$27.16	\$8,849 (per room) ²
^{1.} Includes 2% administrative charge ^{2.} Equivalent to \$17.70/square foot, based on 500 gross square feet/room				

Pursuant to State law (AB 602), jurisdictions are required to calculate impact fees for residential development for fees such as the CFF and TIF, on a per square foot basis; this conversion results in the following values (Table 2).

Table 2: Capital Facilities and Transportation Fee (Combined) Maximum Residential Fee Per Square Foot Equivalent¹

Unit Type	Capital Facilities Fee	Transportation Impact Fee	Total
Single-Family	\$8.23	\$11.87	\$20.10
Multi-Family	\$23.48	\$12.47	\$35.95
^{1.} Includes 2% administrative charge			

Commercial Linkage Fee Estimates

The “Commercial Linkage Fee”, a category of Affordable Housing Fee, is a one-time fee charged to commercial projects (i.e. office, retail, industrial developments) to offset or mitigate the demand such development generates for new affordable housing units. The methodology used estimates the “affordability gap” between market-rate units to

accommodate the residential demand from new employee households at different affordability levels (based on employment sectors and wage distribution), and the subsidy necessary to provide housing at an affordable cost to those households. The aggregate subsidy is divided among the projected square footage of new non-residential development, to determine the commercial linkage fee on a per square foot basis. The maximum fee amounts resulting from this calculation are summarized in Table 3, below.

Table 3: Commercial Linkage Fees, Maximum Fee Amounts¹

Land Use Category	Maximum Justifiable fee (per Square Foot)	Current Fee Amounts (per square foot)
Commercial/Retail	\$578.73	\$5.38
Office	\$142.42	\$3.71
Lodging	\$72.86	\$8.98
Industrial	\$143.39	\$14.42
Includes 2% administrative charge		

As shown, the maximum justifiable fee amounts are considerable, and far exceed the feasible amounts that could be paid by new commercial development – this imbalance is a common result in these types of analyses. As such, and as discussed in more detail below, it will be necessary to set the fee at a fraction of the maximum, as was the case in the prior update.

Affordable Housing Fee

The maximum justifiable amount of this fee is established based on the cost otherwise incurred to subsidize construction of affordable units on-site, in the proportion and at the affordability levels specified in the City’s Inclusionary Zoning Ordinance, which as noted proposes an inclusionary rate of 15% for all housing types, including ownership and rental projects.

To calculate the maximum supportable fee, EPS developed prototype projects (single-family detached, townhome and multifamily apartments) to model overall development costs, and market-rate and affordable home values to understand the subsidy necessary for the affordable units. The maximum justifiable in-lieu fee is summarized in Table 4, below:

Table 4: Inclusionary Housing In-Lieu Fee, Maximum Amounts¹

Unit Type	Maximum Fee (per square foot)	Current Fee (per unit)	Current Fee, Equivalent Cost/Sq. Foot²
Single-Family Detached	\$84.24	\$52,203	\$17.40
Townhome	\$42.10	\$51,077	\$25.54
Multi-Family (Condominiums)	\$54.87	\$51,077	\$63.84
Multi-Family (Rental)	\$69.19	\$51,077	\$63.84
1. Includes 2% administrative charge 2. Assumes: Single Family Detached Unit is 3,000 sq.ft, Townhome is 2,000 square feet, and multi-family condos and rental units are 800 square feet			

Sewer and Water Connection Fee

The City’s professional consultant, Raftelis, is preparing the necessary studies to update the City’s water and sewer connection fees. The connection fee is a one-time charge, levied at the time of building permit issuance, versus the water and sewer user rates that are assessed to residential and commercial customers on an ongoing basis for daily or monthly usage/flow. Water connection fees are based on a Single-Family Residence (SFR) “base rate” which is then scaled based on the capacity of different meter sizes, relative to that base. The sewer fee is similarly based on a Single-Family Residential “Equivalent Dwelling Unit” or EDU, with other uses scaled proportionately to that EDU metric based their relative sewer flow.

Note that Pleasanton’s local connection fees are separate from the connection fees charged by Zone 7, which provides the majority of Pleasanton’s water to the City’s local distribution system, and Dublin San Ramon Sanitary District (DSRSD) which operates the wastewater treatment plant in Pleasanton, treating flows within the City’s sewer network. Table 5 summarizes the estimated maximum Water Connection Fee amounts, and Table 6 the maximum sewer connection fee amounts.

Table 5: Maximum Water Connection Fee (Sample Meter Sizes)

Meter Size	Meter Capacity)	2024 Update Maximum Allowable Fee	Current Fee
5/8"	25	\$2,721	\$1,200
3/4"	35	\$3,809	\$1,800
1"	55	\$5,986	\$3,000
1.5"	160	\$17,416	\$6,000
2"	160	\$17,416	\$19,200

Table 6: Maximum Sewer Connection Fees (Equivalent Dwelling Unit) Sample EDU Rates

	EDU Ratio	Factor	2024 Update Maximum Allowable	Current Fee
Single Family Residential (SFR)	1	unit	\$556.24	\$500
Secondary Dwelling Unit	0.004	square foot	\$2.22	\$2.00
Townhome/Duplex	1	per unit	\$556.24	\$500
Condominium	0.75	per unit	\$417.18	\$375
Apartment/Mobile Home	0.66	per unit	\$367.12	\$330

Next Steps: Development Impact and Affordable Housing Fees

In the coming weeks, EPS’ and Rafetelis’ Impact Fee and Connection Fee Studies will be finalized and published in draft form for City Council and public review. A City Council workshop is scheduled in November to introduce the studies, and to request City Council input and direction on establishment of the appropriate fee rates. As noted, the fee studies identify the maximum level of fees that can be justified, but fees may be set at any level up to this amount.

Staff is reviewing and developing its recommendations with respect to the fees. However, the options that will be presented for City Council discussion will consider the maximum fee amounts, and the aggregate fee burden on various types of new development. A key consideration will be the overall financial feasibility of potential fee increases, and the level to which they can be supported; with the goal of seeking to balance the objective of continuing to support new investment in Pleasanton, with mitigation of growth impacts, through collection of both one-time impact fees and on-going revenues from property and sales tax.

It is noted that, because sewer and water connection fees have not been updated for many years, and the increases are relatively modest in dollar terms, staff previously recommended and City Council supported setting those fees at the maximum rate. And, with respect to the Commercial Linkage fee, the justifiable rates are so far above a feasible level, staff will continue to recommend these be set at just a fraction of the maximum supportable level, as they are today.

However, with respect to TIF, CFF and Affordable Housing Fees, there will be important policy tradeoffs to consider when setting the fees, including, if fees are to be set below the maximum, how to balance potential reductions among the various fee categories (e.g. whether to charge a higher proportion of the maximum Traffic Impact Fee, or Capital Improvement Fee, versus Housing Fee, or vice versa.)

In addition to financial feasibility, there is the opportunity to consider how Pleasanton's fees (individually and in aggregate) compare to those of neighboring and "peer" jurisdictions³, as a means to help assess whether local fees are likely to make Pleasanton more or less competitive as a place to build or do business. It is notable, for example, that Pleasanton's aggregate fees for office construction are some of the highest among the peer cities surveyed, including; whereas, Pleasanton's affordable housing fees in some categories, such as single-family residential, are well below those of neighboring communities.

Inclusionary Zoning Ordinance

On September 11, 2024, the Planning Commission recommended adoption of a comprehensive update to the IZO, based on key policy direction provided by City Council. The City Council will be considering the draft Ordinance at an October 15 Study Session. The October 15 Agenda Report to City Council is available at : <https://pleasantonca.portal.civicclerk.com/event/303/files/report/654>

Key substantive changes recommended in the updated IZO include:

- Reducing the inclusionary rate from 20% to 15% for single family projects, making it consistent with the multi-family rate (i.e., the rate would be 15% across the board)
- Establishing a moderate-income target affordability for for-sale inclusionary units (up to 120% AMI), and low-income target (50% and 60% AMI) for rental inclusionary units.
- Disallowing Accessory Dwelling Units (ADUs) from "counting" toward IZO-required units, since the City cannot compel such units to be rented, and monitoring and enforcing affordability restrictions of such units is extremely challenging.
- Providing more clear and objective standards for the design, configuration and location of inclusionary units within market-rate projects, such as minimum unit sizes, bedroom counts, clustering of affordable units, and amenities. The revisions in some cases provide more flexibility around aspects such as unit size and clustering than the current ordinance, to help improve the financial feasibility of constructing those units.
- Continuing to allow alternative means of compliance with the IZO (for example, building units off-site, or dedicating land for housing), but providing more clear and objective criteria for approval, as well as making the City Council the approving body for all alternative compliance proposals, including payment of in-lieu fees.

³ Peer cities for the purposes of the study include Danville, Dublin, Fremont, Livermore, San Ramon and Walnut Creek

If the draft changes are supported by City Council, staff would bring the IZO back for formal review and adoption in November.

Conclusion

The Impact Fee updates provide an important opportunity to ensure that the fees charged to new development are in alignment with the necessary and actual costs to provide new facilities, infrastructure, and affordable housing demands caused by that development.

In coming weeks, the City Council will have the opportunity to consider the outcomes of the fee studies and in particular evaluate the balances and trade-offs between charging fees at the maximum amounts supported by the study, versus strategic or targeted reductions to reflect fee amounts feasible for new development. And if fees are reduced, the City Council will have to consider by what amount, and in what fee categories.

Prepared and Submitted By: _____ :

A handwritten signature in black ink, appearing to read "Ellen Clark". The signature is fluid and cursive, with the first name "Ellen" and last name "Clark" clearly distinguishable.

Ellen Clark
Community Development Director