CITY OF SALINAS
COUNCIL STAFF REPORT

DATE: **May 16, 2017**

DEPARTMENT: **COMMUNITY DEVELOPMENT DEPARTMENT**

FROM: **MEGAN HUNTER, DIRECTOR**

BY: **CHRISTOPHER VALENZUELA, COMMUNITY DEVELOPMENT ANALYST**

TITLE: **INCLUSIONARY HOUSING ORDINANCE AMENDMENT**

RECOMMENDED MOTION:

A motion to approve amendments to Article 3 (Housing) of Chapter 17 (Housing) of the Salinas Municipal Code related to the provision of Inclusionary Housing.

A motion to approve a Resolution establishing for-sale housing in-lieu fees and rental housing impact fees.

A motion to approve a Resolution authorizing amendments to Inclusionary Housing Guidelines.

RECOMMENDATION:

It is recommended that the City Council take action on the following three Resolutions:

1. Approve Resolution authorizing amendments to Article 3 (Housing) of Chapter 17 (Housing) of the Salinas Municipal Code related to the provision of Inclusionary Housing; and
2. Approve Resolution authorizing approval of residential for-sale housing in-lieu fees and rental housing impact fees; and
3. Approve Resolution authorizing amendments to Inclusionary Housing Guidelines.

EXECUTIVE SUMMARY:

The City Council authorized staff as part of the City's 2015-23 General Plan Housing Element under "*Action H-8: Inclusionary Housing*" to update the existing 2005 Ordinance (Ordinance No. 2451). The proposed 2017 Ordinance will provide much greater flexibility and options to better reflect current and future market conditions and strives to achieve the primary goal of producing affordable housing units.

BACKGROUND:

Inclusionary housing is one of several tools used by the City to help produce housing that is affordable to low and moderate-income households. The City currently has over 700 inclusionary housing units (rental and ownership) in its existing housing portfolio. The City's original Ordinance was adopted in 1992 (Ordinance No. 2178). Since 1992, the City updated and adopted its existing Ordinance (Ordinance No. 2451) in 2005 which currently requires housing developers (that build ownership units) to include a specified percentage of low and moderate-income housing in new residential developments of ten units or greater. However, due to a California court case known as [1]*Palmer/Sixth Street Properties, L.P. v. City of Los Angeles* (Palmer) which is in reference to the Costa-Hawkins Residential Rent Control Act, the existing Ordinance inclusionary on-site requirements do not currently apply to rental housing.

As part of the City's 2015-23 General Plan Housing Element update, the City Council directed staff under "*Action H-8: Inclusionary Housing*" to update the existing Ordinance along with a nexus study. Furthermore, the City Council approved the selection of the Technical Advisory Committee (TAC) to serve as the recommendation committee regarding the Ordinance update. The TAC is composed of various members from the development community and housing advocates. In addition, the City contracted with Baird and Driskell Community Planning to assist with drafting the Ordinance update. The TAC worked with city staff, inclusionary housing consultant and members of the public during the draft Ordinance update process. The CDBG/Housing Subcommittee also serves as a recommendation committee regarding general housing policies to the City Council. The CDBG/Housing Subcommittee is a three-member committee consisting of current City Council members. Below is a list of prior TAC, CDBG/Housing Subcommittee and City Council meetings that were conducted throughout the draft Ordinance update process.

1. December 8, 2014 (TAC Introduction Meeting)
2. July 1, 2015 (TAC)
3. March 9, 2016 (TAC)
4. March 22, 2016 (TAC)
5. April 18, 2016 (TAC)
6. May 19. 2016 (TAC)
7. June 22, 2016 (TAC)
8. July 20, 2016 (TAC)
9. August 2, 2016 (TAC)
10. August 16, 2016 (TAC)
11. September 1, 2016 (CDBG/Housing Subcommittee)
12. November 1, 2016 (City Council Housing Study Session)
13. December 12, 2016 (TAC)

1 In Palmer/Sixth Street Properties, L.P. vs. the City of Los Angeles, a California appellate court found that an inclusionary requirement requiring affordable rental units in Los Angeles was inconsistent with state law prohibiting rent control in new rental units and upon vacancy. This means that cities may only require affordable housing for projects in which it provides financial or other regulatory incentives.

14. January 19, 2017 (TAC)
15. March 2, 2017 (TAC)
16. March 15, 2017 (Planning Commission)
17. March 17, 2017 (CDBG/Housing Subcommittee)
18. April 4, 2017 (TAC)
19. April 19, 2017 (TAC)

DISCUSSION:

The goal of the draft Ordinance update is to achieve a more balanced Ordinance with a greater likelihood that inclusionary units will be constructed on-site. After an extensive draft Ordinance update process which included fifteen TAC meetings, two CDBG/Housing Subcommittee meetings, one Planning Commission meeting and one City Council housing study session, staff is forwarding recommendations to the City Council for consideration and final adoption. Staff is recommending that the City Council adopt the following recommendations listed below in Table 1. Table 1 provides a summary of staff recommendations being forward to the City Council regarding the draft Ordinance update.

Table 1
Summary of Proposed
Inclusionary Housing Ordinance Staff Recommendations

Base Options			
1-9 Units On-Site/Fee Requirements	Exempt		
10+ Units On-Site Options	Mixed Ownership/Rental	Ownership	Rental
	*20%	15%	*12%
Very Low-Income (50% of Median)	*4% (Rental/Ownership)	Not Required	*8% (Rental)
Low-Income (80% of Median)	*8% (Rental/Ownership)	Not Required	*4% (Rental)
Median-Income (100% of Median)	Not Required	6% (Ownership)	Not Required
Moderate-Income (120% of Median)	4% (Ownership)	6% (Ownership)	Not Required
Workforce-Income (160% of Median)	4% (Ownership)	3% (Ownership)	Not Required

Additional Options			
Ownership In-Lieu Fee	$12.00/sq. ft.	$12.00/sq. ft.	Not Required
Rental Housing Impact Fee	*$2.00/sq. ft.	Not Required	*$2.00/sq. ft.
Additional Options, Exemptions and Provisions			
Exemptions	• One-hundred percent (100%) affordable low-income housing developments. • Projects that are not residential developments, including residential developments creating fewer than ten additional dwellings or lots. • Residential developments, which are developed pursuant to the terms of a development agreement, executed prior to the effective date of this Ordinance. • Residential developments located in the Downtown Area (as defined by the Central City Overlay District per Zoning Code 37-40.300). • Residential developments that have submitted a complete planning or building permit application along with full payment of required application fees to the City prior to the effective date of this Ordinance (pipeline projects). • If a comparable market-rate ownership unit (unit type, size, bedroom count) would sell at or below the affordable ownership price, it does not need to have a deed restriction.		
Timing of Production	• City may issue building permits for 50% of market-rate units within a residential development before issuing building permits for inclusionary units. • City may issue building permits for 75% of market-rate units within a residential development before issuing building permits for inclusionary units if the developer collaborates with an experienced non-profit affordable housing provider.		
Type of Units	• Inclusionary workforce-income units may have smaller lots than market-rate units. • Inclusionary moderate-income and median-income units can be built as townhomes or small-attached developments. • Rental inclusionary units may be clustered as needed in multifamily or other housing types to provide eligibility for tax credits.		

Offsite Construction	• Must be built within the Future Growth Area. • Access to public transportation shall be equal or greater. • Has a General Plan and zoning designation to accommodate at least the required number of inclusionary units. • Must be suitable for development of the inclusionary units in regards to physical characteristics, location, access, adjacent uses, and other relevant and development criteria. • Any hazardous materials or geological hazards shall be mitigated and site shall not be located in a 100-year flood plain. • Construction schedule for the off-site inclusionary units shall be included in the affordable housing plan.
Partnerships	• Applicant may elect to contract with another experienced developer (market-rate or non-profit). • City Council must approve all partnerships.
Land Dedication	• Marketable title. • Access to public transportation shall be equal or greater. • Has a General Plan and zoning designation to accommodate at least the required number of inclusionary units. • Must be suitable for development of the inclusionary units in regards to physical characteristics, location, access, adjacent uses, and other relevant and development criteria. • Any hazardous materials or geological hazards shall be mitigated and the site shall not be located in a 100-year flood plain. • Adequate infrastructure to serve the dedicated site.
Credit/Transfer Program	• Developments that produce and use credits must be located within the Future Growth Area. • Initial 5 yr. credit term, with a possible 5 yr. extension for a maximum of 10 yrs. • Must have the same tenure (rental or ownership) and at least as many bedrooms. • Producing and using credits must be approved by City Council.
Resale Formula	• Shared appreciation, 30 yr. term.
Rehabilitation of Existing Units	• Not allowed.
Alternative Proposals	• Developer may submit an alternative proposal, which must be approved by City Council.
Ordinance Review Period	• To be reviewed and updated (if necessary) every five years.

*Affordable on-site rental requirements currently not required due to State Costa-Hawkins Act, Palmer/Sixth Street Properties L.P. v City of Los Angeles Court Case. If the legal environment changes regarding affordable on-site rental requirements, the above percentages would apply. Residential rental housing impact fees are being proposed as part of the Ordinance update.

The TAC covered many topics at their meetings and were able to reach agreement on much of the draft Ordinance recommendations. However, there were differences of opinion among the TAC members on a few outstanding items in which no consensus was reached. Table 2 below highlights those items that lack consensus and includes TAC member alternative recommendations.

Table 2
Summary of Non-Consensus
Inclusionary Housing Ordinance Items

Ordinance Item	Recommendation		
	Staff	Non-Profit Development Community/Housing Advocates	Market-Rate Development Community
10+ Units Mixed Ownership/Rental	<u>20%</u> 4% - Very Low (R/O) 8% - Low (R/O) 4% - Moderate (O) 4% - Workforce (O)	<u>20%</u> 4% - Very Low (R/O) 8% - Low (R/O) 4% - Moderate (O) 4% - Workforce (O)	<u>16%</u> 4% - Very Low (R/O) 4% - Low (R/O) 4% - Moderate (O) 4% - Workforce (O)
10+ Units Ownership	<u>15%</u> 6% - Median (O) 6% - Moderate (O) 3% - Workforce (O)	<u>15%</u> 6% - Median (O) 6% - Moderate (O) 3% - Workforce (O)	<u>12%</u> 4% - Median (O) 4% - Moderate (O) 4% - Workforce (O)
10+ Units Rental	<u>12%</u> 8% - Very Low (R) 4% - Low (R)	<u>12%</u> 8% - Very Low (R) 4% - Low (R)	<u>12%</u> 4% - Very Low (R) 4% - Low (R) 4% - Median (R)
Ownership In-Lieu Fee	$12.00/sq. ft.	$12.00/sq. ft.	$2.00/sq. ft. - $6.00/sq. ft. Sliding Scale Based On Unit Size
Rental Housing Impact Fee	$2.00/sq. ft.	$5.00/sq. ft. or $2.00/sq. ft. (w/Housing Vouchers)	$2.00/sq. ft.

Timing of Production (# of Market-Rate Building Permits Allowed Prior to Inclusionary Units)	50% or 75% (w/non-profit)	50% or 75% (w/non-profit)	70% or 100% (w/non-profit)
Rental Restriction Term	30 yrs.	55 yrs.	30 yrs.

R = Rental, O = Ownership

Below is additional background summary information regarding outstanding items in which no consensus was reached by members of the TAC during the draft Ordinance update process.

- On-Site Percentage Options:
  - Background Summary: The proposed on-site percentage requirements of 20% (Option 1 – Mixed), 15% (Option 2 - Ownership) and 12% (Option 3 – Rental) strive to provide viable options that represent similar costs equivalency whether providing ownership or rental units (voluntarily) on-site.
  - Non-Profit Development Community/Housing Advocates: Recommend that the proposed on-site percentage requirements of 20% (Option 1 – Mixed), 15% (Option 2 - Ownership) and 12% (Option 3 – Rental) remain. Expressed that the proposed on-site percentage requirements provide market-rate developers with a menu of feasible options, which are lower than the 2005 Ordinance requirements.
  - Market-Rate Development Community: Recommend a reduction of the proposed on-site percentage requirements to 16% (Option 1 – Mixed), 12% (Option 2 – Ownership) and 12% (Option 3 – Rental by adding the median-income category). Expressed that the current residential real estate market has not fully recovered and a slight reduction of on-site percentage requirements will make it more feasible to produce inclusionary units on-site.
- Residential Ownership In-Lieu Fee:
  - Background Summary: The preference is to have inclusionary ownership units constructed on-site rather than receive payment of a residential ownership in-lieu fee. The proposed in-lieu fee amount of $12.00/sq. ft. is proposed to be set high enough to encourage construction of inclusionary ownership units on-site rather than payment of an in-lieu fee. If the residential ownership in-lieu fee is set too low, there would be little to no incentive to construct inclusionary ownership units on-site.
  - Non-Profit Development Community/Housing Advocates: Recommend that the proposed residential ownership in-lieu fee remain at $12.00/sq. ft. Expressed that the proposed in-lieu fee of $12.00/sq. ft. represents the goal of encouraging market-rate developers to construct inclusionary ownership units on-site rather than paying a fee. Concerned that an in-lieu fee even at $12.00/sq. ft. would not

be enough for the City to turnaround and be able to sufficiently subsidize or construct affordable housing.

  - Market-Rate Development Community: Recommend a reduction of the proposed residential ownership in-lieu fee utilizing a sliding scale methodology between $2.00/sq. ft. - $6.00/sq. ft. based on the unit sizes with a maximum fee range of $3,000 - $12,000. Expressed that the proposed $12.00/sq. ft. residential ownership in-lieu fee is infeasible.
- <u>Residential Rental Housing Impact Fee</u>:
  - Background Summary: Due to the Palmer Court Case, the City cannot currently require market-rate rental developers to construct inclusionary rental units on-site. The nexus study and updated rental feasibility study found that the profit margin for rental developers in current market conditions is much more marginal then for ownership developers. The proposed $2.00/sq. ft. residential rental housing impact fee is proposed to be set low enough to not discourage market-rate rental development from being constructed.
  - Non-Profit Development Community/Housing Advocates: Recommend that the proposed residential rental housing impact fee be set at $5.00/sq. ft. unless the developer receives project-based Section 8 Housing Voucher subsidies, than can be lowered to $2.00/sq. ft.
  - Market-Rate Development Community: Recommend that the proposed residential rental housing impact fee be set at no more than $2.00/sq. ft.
- <u>Timing of Production:</u>
  - Background Summary: The proposed timing of production schedule of 50% and 75% (w/non-profit) strives to ensure that inclusionary on-site units are appropriately disbursed throughout the development.
  - Non-Profit Development Community/Housing Advocates: Recommend that the proposed timing of production schedule of 50% and 75% (w/non-profit) remain. Expressed that inclusionary on-site units may be built too late in a development if percentages are relaxed further.
  - Market-Rate Development Community: Recommend that the proposed timing of production schedule be amended to 70% and 100% (w/non-profit). Expressed concern that market-rate developers do not experience a profit until later in their production schedule.
- <u>Rental Restriction Affordability Term</u>:
  - Background Summary: The inclusionary rental restriction affordability term is proposed to be set at 30 years as per the existing 2005 Ordinance.
  - Non-Profit Development Community/Housing Advocates: Recommend that the proposed rental restriction affordability term be increased from 30 years to 55 years. Wanted to preserve long-term affordability of rental housing stock. Mentioned that 55 years is common with other requirements such as the California Tax Credit Allocation Committee (CTCAC) and State Density Bonus Law.

- Market-Rate Development Community: Recommend that the proposed rental restriction affordability term remain at 30 years. Expressed that rental restrictions might affect a market-rate developer's ability to qualify for a refinance of their development in the future.

Throughout the process, stakeholders may not have achieved all of their policy goals, but the initial goal of the TAC was to try and find solutions that achieved a balanced Ordinance that would produce inclusionary units on-site. Table 3 below provides a side-by-side comparison of the original 1992 Ordinance, existing 2005 Ordinance and draft 2017 Ordinance along with the overall benefiting party. In summary, the draft 2017 Ordinance provides much greater flexibility and options to the market-rate development community than the original 1992 Ordinance and existing 2005 Ordinance.

Table 3
Summary Comparison of
1992 Ordinance, 2005 Ordinance and Proposed 2017 Ordinance

Ordinance Item	1992 Ordinance	2005 Ordinance	2017 Ordinance (Proposed)	2017 Ordinance (Proposed) Summary	Overall Beneficiary
On-Site % Requirements	12%	20%, 25%, 30%	12%, 15%, 20%	Lower % requirements than 2005 Ordinance	Market-Rate Development Community
Ownership In-Lieu Fee	No Option	Only available w/Option #3 (35%), complicated formula	$12.00/sq. ft.	In-lieu fee for all ownership options	Market-Rate Development Community
Rental Housing Impact Fee	No Option	No Option	$2.00/sq. ft.	Rental housing impact fee for all options	Minimal Funding For Housing
Credit Transfer Program	No Option	No Option	Available	Option now available in FGA	Market-Rate Development Community
Income Categories	Very Low & Low	Very Low, Low, Moderate & Workforce	Very Low, Low, Median, Moderate & Workforce	Added median-income category for ownership	Market-Rate Development Community

100% Affordable Housing Projects	Not Exempt	Not Exempt	Exempt	Exempt	Non-Profit Development Community/Housing Advocates
Partnerships	Non-Profit Only	Only available w/Option #3 (35%), Non-Profit Only	Non-Profit or Market-Rate Developer	Option available	Market-Rate Development Community
Ordinance Item	1992 Ordinance	2005 Ordinance	2017 Ordinance (Proposed)	2017 Ordinance (Proposed) Summary	Overall Beneficiary
Downtown Area Exemption	Not Exempt	Not Exempt	Exempt	Exempt	Market-Rate Development Community
Exemptions Based on Market Price	Not Exempt	Not Exempt	Exempt	Option available	Market-Rate Development Community
Resale Formula Method	Resale Restriction – AMI	Shared Appreciation (30 yrs.)	Shared Appreciation 30 yrs. – Revised Formula	Revised formula incentivizes long-term ownership	City/Homeowner
Offsite Construction	No Option	No Option	Available	Option available in FGA	Market-Rate Development Community
Timing of Production (# of Market-Rate Building Permits Allowed Prior to Inclusionary Units)	30% or 50% (w/non-profit)	90%w/Options 2 (25%) and 3 (35%)	50% or 75% (w/non-profit)	More profit to fund inclusionary housing	Market-Rate Development Community
Land Dedication	No Option	Only available w/Option #3 (35%)	Available	Option available	Market-Rate Development Community
Pipeline Projects	No Option	No Option	Available	Option available	Market-Rate Development Community

Type of Units	No Option	Limited Option	Available	Option Available	Market-Rate Development Community
Alternatives	No Option	Only available w/Option #3 (35%)	Available	Option available	Market-Rate Development Community

NEXUS STUDY UPDATE:

The underlying concept of the residential nexus analysis is that newly constructed units represent net new households in Salinas, resulting in new local spending. New local spending generates new local jobs, a portion of which are at lower compensation levels. Low compensation jobs result in lower income households that cannot afford market-rate units in Salinas and therefore, need affordable housing. The purpose of the residential component is to mitigate the impact of new residential development on the need for affordable housing, to ensure that housing constructed in Salinas meets the needs of all income groups, and to provide the City with a supply of affordable housing for households working and residing in Salinas.

RESIDENTIAL OWNERSHIP IN-LIEU AND RENTAL HOUSING IMPACT FEES:

To be consistent with the existing legal environment which includes the Palmer court case, the Ordinance update will include language regarding residential rental development, so that developers of market-rate rental units, where the units cannot be sold individually, have an option to pay a residential rental housing impact fee that will be deposited in the City's Inclusionary Housing Trust Fund. As an alternative option within the draft Ordinance, market-rate developers could propose on-site inclusionary rental units. However, to ensure compliance with the Costa-Hawkins Residential Rent Control Act (Civil Code Section 1954.50 et seq.), the City may approve on-site rental inclusionary units only if the applicant agrees in a rent regulatory agreement with the City to limit rents in consideration for a direct financial contribution or a form of assistance specified in Density Bonus Law (Government Code Section 65915 et seq.).

There will also be an option for residential for-sale developments to pay an ownership in-lieu fee rather than providing ownership inclusionary units on-site. Both residential ownership in-lieu and rental housing impact fees will not require additional City Council approval in order for a developer to satisfy their inclusionary obligation. The proposed residential ownership in-lieu fee amount is $12 per square foot. The proposed residential rental housing impact fee amount is $2 per square foot. Residential ownership in-lieu and rental housing impact fees will be due and payable at the issuance of building permits and calculated based on the fee schedule in effect at the time the building permit is issued. Specific details regarding annual fee adjustments, dollar amounts, and applicability of the fee to gross square footage are included in the attached fee resolution.

In the past, prior to the Palmer court case the City imposed on-site affordable housing rental requirements. This option is not currently available after publication of the Palmer decision. Cities cannot currently require developers to provide affordable rental housing as part of their projects. Revenue from residential ownership in-lieu and rental housing impact fees would provide the City with an important tool for the creation of affordable housing. The fees would be deposited in the City's Inclusionary Housing Trust Fund to be utilized primarily for the creation of new affordable housing. The housing impact fee nexus study analysis establishes the maximum supportable residential ownership in-lieu and rental housing impact fee levels that the City can legally require.

Fee recommendations are based on the following factors:

- Findings of the nexus study and supplemental feasibility studies; and
- Policy objectives of the General Plan Housing Element; and
- Requirements in neighboring jurisdictions – staying competitive with neighboring cities; and
- For ownership projects, setting a fee high enough to encourage construction of units on-site; and
- For rental projects, since the Palmer case precludes the City from requiring on-site units, setting a fee low enough to not discourage rental developments.

INCLUSIONARY HOUSING GUIDELINES:

The Guidelines clarify and outline the procedures and requirements for the Ordinance. The Guidelines also establish the procedures for on-going administration of existing and newly constructed inclusionary housing units. The Guidelines include procedures for prioritizing applicants, evaluating the eligibility of applicants, setting maximum affordable rents and sales prices and monitoring compliance of tenants and homeowners with recorded affordability covenants. The Guidelines provide overall guidance and clarification of the Ordinance requirements for City staff, general public, inclusionary homeowners and renters, and property managers of rental complexes. The draft Guidelines are also being revised as part of the overall Ordinance update.

CEQA CONSIDERATION:

The City of Salinas has determined that the proposed action is not a project as defined by the California Environmental Quality Act (CEQA) (CEQA Guidelines Section 15378). In addition, CEQA Guidelines Section 15061 includes the general rule that CEQA applies only to activities which 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. Because the proposed action and this matter have no potential to cause any effect on the environment, or because it falls within a category of activities excluded as projects pursuant to CEQA Guidelines section 15378, this matter is not a project. Because the matter does not cause a direct or foreseeable indirect physical change on or in the environment, this matter is not a project. Any subsequent discretionary projects resulting from this action will be assessed for CEQA applicability.

STRATEGIC PLAN INITIATIVE:

The adoption of the Ordinance, Guidelines and proposed residential ownership in-lieu and rental housing impact fees are in concurrence with the following City goals, policies and plans.

- 2016-19 Salinas City Council Strategic Plan
    - Goal IV - Well Planned City and Excellent Infrastructure
    - Objective – Update and adopt a new Inclusionary Housing (or Housing Fee) Ordinance to support affordable housing
- 2015-23 General Plan Housing Element
    - Action 8: Inclusionary Housing
- 2015-19 HUD Consolidated Plan

FISCAL AND SUSTAINABILITY IMPACT:

On April 4, 2017, the City Council authorized approval of a budget transfer from the Community Development Housing Division General Fund account (1000.30.3220-61 Salaries & Benefits) to the Inclusionary Housing Ordinance Update (CIP 9041) account (5800.30.9041) for $50,000 (Resolution No. 21149). Sufficient funding is available for remaining legal, consultant and staff expenses to complete the draft Ordinance update.

If adopted, residential for-sale in-lieu fees and rental housing impact fees will go in effect 60 days after City Council adoption. Residential for-sale in-lieu fees and rental housing impact fees will be added to the City fee schedule and future revenues will be deposited into the Inclusionary Housing Trust Fund.

ATTACHMENTS:

- Inclusionary Housing Ordinance Resolution
- Fee Resolution
- Inclusionary Housing Guidelines Resolution
- Nexus Study and Supplemental Feasibility Studies