TO: HONORABLE CITY COUNCIL

ATTN: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: PLANNING AND COMMUNITY ENVIRONMENT

DATE: FEBRUARY 20, 2002 CMR:150:02

SUBJECT: RECOMMENDED INCREASE TO COMMERCIAL HOUSING IN-LIEU FEE AND TRANSPORTATION IMPACT FEE FOR STANFORD RESEARCH PARK/EL CAMINO REAL SERVICE COMMERCIAL ZONE

REPORT IN BRIEF

In 1984, the City of Palo Alto adopted an ordinance requiring developers of commercial and industrial projects to develop below market rate housing or pay a housing fee as mitigation for the impacts on housing attributable to jobs created by commercial development. Neither the provisions of the ordinance nor the fee formula have been altered since minor amendments were made in 1985. The current fee rate is $4.21 per net new square foot. A recent economic nexus study (CMR 383:01) demonstrates that the cost of providing housing affordable to the low and moderate-income households attributable to new commercial development has increased significantly since the last study conducted in 1993. An increase in the housing fee base rate to $12.00 per square foot is recommended by staff to ensure that commercial projects mitigate a significant portion of the affordable housing impacts.

In 1989, the City of Palo Alto adopted an ordinance implementing a fee on new nonresidential development to offset capital costs associated with capacity improvements at eight intersections near the Stanford Research Park / El Camino Real Service Commercial (CS) Zone. The fee is based on cost estimates for intersection improvements, and has not been updated since adoption. A recent analysis indicates that the cost of these intersection improvements has increased significantly since 1989. The current fee rate is $3.03 per net new square foot. An increase in the transportation impact fee to $8.20 per square foot is recommended by staff to ensure that development projects bear the full capital costs to provide capacity improvements.
RECOMMENDATION
Staff recommends that the Finance Committee:

1) Recommend to the City Council that Chapter 16.47 of the Municipal Code be amended to increase the Commercial Housing In-Lieu Fee from its current level of $4.21 per square feet to an initial base fee of $12.00 per square foot, with annual revisions to account for inflation;

2) Recommend to the City Council that Chapter 16.45 of the Municipal Code be amended to increase the Transportation Impact Fee from its current level of $3.03 per square feet to an initial base fee of $8.20 per square foot, with annual revisions to account for inflation;

3) Recommend to the City Council that fee increases apply only to development projects currently in the “pipeline” where a complete application for discretionary approval, including a complete preliminary Architectural Review Board application, has not been submitted as of the effective date of the ordinance. Projects submitted or applications completed after the effective date of the ordinance will be subject to the increased fee.

BACKGROUND
In July 2001, staff contracted with Keyser Marston to update its 1993 housing nexus study, to develop a revised total linkage cost and assist staff in recommending an increase to the base fee rate. Results of the study and staff recommendations were presented to the Finance Committee on October 16, 2001. That report (CMR:383:01) included a complete background on the commercial housing in-lieu fee in Palo Alto, an analysis of the updated nexus study, a comparison of housing fees in other cities, and staff recommendations for possible new fee levels for Palo Alto. A report concerning new impact fees for parks, community centers and libraries (CMR:381:01) was presented at the same meeting. The report also included an estimated increase to the transportation impact fee level.

The Finance Committee directed staff to hold an outreach session with the community, and return to the Committee with recommendations once community sentiment was evaluated. The Finance Committee also directed staff to present proposed changes to housing and transportation impact fees at the same time, along with any new fees, in order to consider all of the fees together.

DISCUSSION
Public Outreach
A public forum to discuss development impact fees was held December 19, 2001. Twenty members of the community, including three members of City Council, attended
the forum. While most of the discussion at the meeting related to proposed new fees, the group was also supportive of an increase in the existing housing impact fee level.

At the end of the public outreach meeting, staff distributed a survey to each participant to collect additional input. Ninety-three percent of survey responses support an increase in the housing impact fee. In terms of fee level, 23 percent of responses support the fee level as proposed, while 77 percent of responses support a fee greater than $12 per square foot.

The December 19 survey also queried participants on a potential citywide traffic impact fee. Ninety-two percent of responses supported an evaluation of such a fee. The survey did not include a question regarding the fee levels of existing transportation impact fees.

Transportation Impact Fee
The Stanford Research Park/El Camino Real transportation impact fee ordinance was adopted in 1989 as an outcome of the Citywide Land Use and Transportation Study. It is one of two traffic impact fee ordinances (San Antonio/East Bayshore is the other). The fee is determined by the cost of improvements at eight intersections, estimated in 1989 at $4.285 million. Neither the intersection projects nor their costs have been updated since the ordinance was adopted in 1989.

The fee is adjusted each year for increases in the cost of construction based on the San Francisco Bay Area Construction Cost Index. In 1989 the fee was $2.39 per new square foot of development in the Stanford Research Park/El Camino Real CS Zone. Annual cost index adjustments have resulted in a fee of $3.03 in 2001, a 27 percent increase since 1989.

The list of intersection projects in the current ordinance is out of date. Some have been finished and others have been revised by the new Comprehensive Plan. The current intersection projects listed in the Comprehensive Plan that can be funded by this fee are:

- Page Mill/Hanover;
- Middlefield Road/Oregon Expressway;
- Foothill/Arastradero/Miranda; and
- Page Mill Expressway/El Camino Real.

In 2001 Korve Engineering performed a study to re-evaluate cost estimates for capacity improvements at these intersections (see Attachments A and B). Korve Engineering estimates total $14.7 million, and include right-of-way or easements at a cost of $125 per square foot, as well as design, construction, and management costs. Also included is a contingency for each project.

The original estimated costs in 1989 have increased to those projected in 2001 by 343 percent (see Attachment B). Staff recommends increasing the original 1989 base impact
fee by the same percentage. This will result in an impact fee of $8.20 per square foot ($2.39 x 343 percent). Compared to the current fee of $3.03, this represents a 270 percent increase.

Staff had not completed its analysis on an updated fee level for intersection improvements prior to the December 19th public forum. The estimated fee level projected at that time was $6.10 per square foot, rather than $8.20. Staff recommends the higher fee level in order to recover intersection improvement costs as estimated by Korve Engineering, based on the revised project list.

**RESOURCE IMPACT**

Precise revenue projections for future housing fees if the proposed increase to $12 per square foot is adopted are not possible. Most commercial projects presently in development review, such as Hyatt Rickey’s and 800 High Street, provide a significant number of housing units within the project and therefore, under the provisions of the current ordinance, will not be required to pay a commercial housing fee. Thus, it will probably not be until the economy is well into recovery that the results of the proposed fee increase will be seen in the Commercial Housing In-Lieu Fund. However, if the $12 fee rate had applied to the commercial projects paying housing fees during the last fiscal year (2000-01), about $4.2 million would have been deposited to the Commercial Housing In-Lieu Fund versus the $1.4 million received with the current $4.21 fee. An acre to an acre and one-half of residential land could have been purchased at current values with $4 million in funds.

Projections for future traffic impact fees are also difficult, as the amount of development in any single year varies greatly. However, a comparison of fee levels using remaining development potential may be useful. The Comprehensive Plan identifies approximately one million square feet of development potential in the Stanford Research Park/El Camino Real CS Zone, including the Mayfield site (290,000 square feet). Since adoption of the Comprehensive Plan in 1998, approximately 561,000 new square feet have been constructed or approved in the impact area, including 2475 Hanover. The remaining development potential is 529,000 square feet. If the existing fee were applied it would yield $1.6 million ($3.03 x 529,000). The proposed fee would yield $4.3 million ($8.20 x 529,000). Actual fee collection will be a function of the year in which development occurs, and any future adjustments to the fee for inflation or updates to the project list.

**POLICY IMPLICATIONS**

The housing fee ordinance is based on the long-standing City policy that commercial developers should contribute to the cost of meeting the affordable housing needs of their work force. The housing fee increase recommended by staff is intended to ensure that a significant portion of the affordable housing impacts of such projects are mitigated but, at the same time, commercial development remains viable in Palo Alto. A $12 housing fee
would be comparable to the housing fee rate in San Francisco ($14) Seattle ($12) and
Menlo Park ($10).

The transportation fee ordinance was an outcome of the Citywide Land Use and
Transportation Study. The purpose of the fee was to ensure that new development
collectively bears responsibility for capital expenditures needed to provide capacity
improvements as defined in the ordinance. The transportation fee increase recommended
by staff is intended to support this goal by updating the list of capacity improvements and
associated costs.

**ALTERNATIVES TO STAFF RECOMMENDATION**
The following are possible alternatives to staff’s recommended adoption of proposed
impact fee increases:

1) Decide not to increase fee levels at this time, leaving the current fees intact;

2) Decide to postpone, or phase-in, recommended fee increases;

3) Set the housing fee at a higher (or lower) level than the $12 per square foot
   recommended by staff. Seventy-seven percent of survey respondents supported a fee
   level higher than that proposed by staff. The nexus study update justifies a housing
   impact fee rate of up to $57.81 per square foot, which would, on average, cover 100
   percent of the affordable housing costs generated by a prototype commercial project. Council
could choose to set the housing fee at any amount from the current $4.21 up
to the $57.81 maximum supported by the consultant’s study. Other cities have
housing fee levels ranging from $0 to $14 per square foot;

4) Set the transportation fee at a higher (or lower) level than the $8.20 per square foot
   recommended by staff. Preliminary estimates presented to the public in October and
   December 2001 for this fee were $6.10 per square foot. Conversely, spreading the
current estimated cost of proposed intersection improvements over the remaining
development potential results in a fee level of $27.79 per square foot ($14.7 million/
529,000 square feet), a nine-fold increase in the current fee. Other cities have
transportation fee levels ranging from $0 to $12.73 per square foot.

**TIMELINE**
Once the Finance Committee recommends specific fee levels to staff, staff will prepare
ordinance amendments for Council adoption to enact the new housing and transportation
fees. New fees can be instituted 60 days following ordinance adoption.

Staff plans to initiate a second phase of the review and evaluation of the housing fee after
adoption of the fee increase. A draft work program extending the current contract with
Keyser Marston has been prepared, but staff has not executed the contract amendment
pending Council input and direction on policy issues that affect the work program. After
completion of the second phase, staff will return to Council with a revised ordinance for review and adoption.

Staff also plans to begin an evaluation of a citywide transportation impact fee, once the transportation division’s traffic model is complete. A nexus study will be required, per AB 1600 legislative requirements. This project will begin next fiscal year, and will require both staff and contract expertise. If necessary, resources will be requested during the 2002-03 Fiscal Year budget process for the project.

ENVIRONMENTAL REVIEW
This action is not a project under the California Environmental Quality Act (CEQA), and does not require CEQA review.

ATTACHMENTS
A. Estimated Cost of Capacity Improvements
B. Comparison of Estimated Cost of Capacity Improvements

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