



City of Palo Alto

City Council Staff Report

(ID # 10715)

Report Type: Action Items

Meeting Date: 6/23/2020

Summary Title: Planned Home Zoning (PC Zoning)

Title: Discussion and Direction to Staff on Housing Affordability Requirements for Projects Proposed Under the Planned Home Zoning (Planned Community Zoning)

From: City Manager

Lead Department: Planning and Development Services

Recommendation

Staff recommends that Council endorse an approach that offers a menu of options to home builders to meet the 20% inclusionary requirement for “planned home zoning”¹ projects and affirm staff’s direction regarding the calculation for determining the number of housing units required to offset net new jobs created by a planned home zoning project.

Executive Summary

On February 3, 2020, Council approved a motion (7-0) to allow residential and mixed-use housing projects that meet certain criteria to propose a planned home zone (PHZ) change.² At the hearing, Council indicated PHZ projects needed to include 20% below market rate (BMR) units across a range of area median income (AMI) levels and ensure more housing units are produced than net new commercial jobs produced.

Council’s motion generated interest from a wide variety of developers and landowners to explore the potential for housing on sites across the City. Staff met with interested parties to communicate Council’s direction and obtain feedback on conceptual designs and anticipated barriers to development of various parcels. However, the ability to move forward is somewhat

¹ Referred to in this report as "Planned Home Zone" to emphasize the focus on housing as the benefit to the community. Still, PAMC Section 18.38, which outlines the requirement and process for Planned Community (PC) Zoning remains the underlying code supporting application of this policy.

² Minutes from February 3, 2020 Council Meeting: <https://tinyurl.com/Feb-3-2020-Council-Minutes>

constrained by a lack of clarity on the inclusionary requirements and jobs/housing factor to be used for these projects. This memo presents some options to better define these requirements.

Background

On February 3, 2014 the City Council voted to place a “time-out” on Planned Community (PC) zoned projects to allow an examination of potential alternatives and reforms.³ Since that date, no re-zonings for PCs have been approved in Palo Alto.

Two years ago, the City Council adopted a housing work plan.⁴ Staff prepared the plan in response to a City Council Colleagues’ Memorandum.⁵ The Colleagues’ Memorandum stated the desire for zoning updates to encourage diverse housing near jobs, transit, and services. The memo presented several specific concepts, many of which were also identified in the City’s Housing Element (adopted November 2014) and the updated Comprehensive Plan (adopted November 13, 2017).

Since that time, Council approved several zoning updates designed to encourage housing production and took other measures to curb office development in favor of housing production. These actions stimulated some housing development; however, the City continues to have a high jobs-to-housing ratio. At the current rate, the City is not on target to meet its expressed Comprehensive Plan goal of producing between 3,545 and 4,420 new housing units between 2015 and 2030. The lack of housing affordable at all income levels contributes to other impacts experienced in Palo Alto. These impacts relate to traffic congestion, higher vehicle miles traveled, greater greenhouse gas emissions, and diminished housing opportunities, among other quality of life issues.

On February 3, 2020, staff presented an update on the Housing Work Plan. At this hearing staff conveyed the conclusion that additional measures would likely be needed to generate near-term housing production that meets the City’s expressed targets. In response, Council approved a motion⁶ to allow for housing projects to be rezoned under the PHZ. Unlike the previous planned community (PC) zoning, the City would not seek community benefits from proposed projects. Instead, the housing itself, especially the required BMR units, serves as the primary community benefit.

Discussion

³ Minutes from February 3, 2014 Council Meeting: <https://tinyurl.com/Feb-3-2014-Council-Minutes>

⁴ City of Palo Alto Housing Work Plan: <https://tinyurl.com/Housing-Work-Plan-PA>

⁵ *Colleagues Memo Regarding Zoning Updates to Encourage Diverse Housing Near Jobs, Transit, and Services*, dated November 6, 2017: <https://tinyurl.com/Colleagues-Memo-Housing>

⁶ February 3, 2020 City Council Minutes:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=69999.18&BlobID=75525>

The PHZ conversation occurred approximately six weeks prior to City Council's declaration of a local emergency due to the COVID-19 pandemic. The impacts of COVID-19 on many aspects of our local community, the region, nation, and the world remain unknown. It is anticipated, however, that this pandemic and the unfolding economic recession will impact real estate supply as well as demand.

At the time of this report's writing, it remains to be seen how demand for housing and supply of new housing units will be impacted by COVID-19. On one hand, the region's severe shortage of housing developed over several decades, during which housing production did not keep pace with housing demand. On the other hand, job loss, remote work, layoffs, and possible changes to employee density in office buildings may lead to less demand for housing. The magnitude of such departures may not be known immediately. That said, the regional population would need to decrease significantly to impact the housing shortage. The need for more housing—and more affordable housing—is unlikely to be significantly abated. The state and region plan to issue revised regional housing needs allocations (RHNA) to regions and jurisdictions later this year; Palo Alto's RHNA numbers are expected to increase significantly.⁷

Despite the pandemic, staff continues to be approached by developers interested in pursuing housing development. In fact, Council will hear a pre-screening request on June 22 for a proposed PHZ. Thus, while the impacts of the pandemic will continue to unfold, there is a need now to provide more certainty around the inclusionary requirement and affirm the appropriate factor to use when assessing the net new jobs to housing unit requirement.

20% Inclusionary Housing Requirement

When discussing the 20% inclusionary requirement, individual Council members had a range of suggestions on how this should be achieved. Some favored promoting the need for lower income units, others favored a spread across all income levels (which is reflected in the final motion) and offered suggestions on how that could be achieved. Still, others expressed an interest in addressing the need for more workforce housing or units in the range between above moderate and market rate housing.

One Council member suggested the benefits of PHZ be provided at the current 15% inclusionary requirement⁸ in recognition that the City is not producing the number of housing units it is

⁷ An informational report on Plan Bay Area and the regional housing needs assessment (RHNA) was transmitted to the City Council and available online on the June 22, 2020 agenda (see page 8):

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=42775&BlobID=77181>

⁸ The fifteen percent (15%) requirement applies to ownership housing, not rental. Rental housing projects are assessed a \$20.87 fee per square foot of residential floor area.

trying to achieve even at this level. A recent report⁹ presented to the Planning and Transportation and shared with the City Council provides some insight into the economic challenges producing on-site BMR housing based on current codes. Moreover, the City's inclusionary requirement for ownership housing is not distributed across all income levels and provides that 10% of the units be deed restricted at 100% of area median income (AMI) for Santa Clara County and 5% restricted at 120% of AMI. Requiring more units deed restricted at the lower income means greater concessions from the zoning code to home builders will be required.

The Council's direction also reflects the perspective that, unlike prior planned community zoning, the Council does not want to engage in a negotiation about the affordability requirements or various concessions required for a project. Staff was directed to engage with home builders on these topics and have the potential applicant present a concept plan to the Council to receive non-binding comments on a conceptual plan. In light of this direction and in recognition that each parcel's site constraints and property owner expectations, motivations and tolerance for risk vary, staff recommends the City Council support a menu approach to address the inclusionary requirement.¹⁰ Four options are presented below – the Council may decide to endorse all four options, select only one or two options for use, or direct staff to consider an alternative approach.

Option 1: 20% Deed Restricted; Balanced Across Affordable and Workforce Housing

This option equally distributes the 20% inclusionary requirement across four income levels. Five percent of a project's deed restricted units would be provided at each of the following income levels: 50%, 80%, 120%, and 140% AMI. Units at or below 120% AMI qualify as below market housing in accordance with the City's municipal code; units between 120% and 150% are defined as workforce housing.¹¹

⁹ June 10, 2020 PTC report regarding below market housing feasibility study:

<https://www.cityofpaloalto.org/civicax/filebank/documents/77084>

¹⁰ For PHZ applications – fractional units shall not be rounded for all Options. Compliance with minimum requirements are met with using whole numbers, for instance, 19.9% does not meet the 20% inclusionary standard.

¹¹ For the purpose of PHZ applications, qualifying projects dedicating units toward workforce housing could not exceed 140% AMI across all options.

Table 1: 20% at BMR and Workforce Housing Income Levels

	Income Level	Area Median Income	Example 100 Unit Project	Income-Restricted Units
Below Market Rate Units	Very-low Income	31-50%	5	5%
	Low Income	51%-80%	5	5%
	Moderate Income	81%-120%	5	5%
Workforce Housing	Above Moderate Income	121% - 140%	5	5%
Market Rate	Above Moderate Income	141% and above	80	80%
Total			100	100%

This option meets the Council’s goal to distribute the deed restricted units across all income levels and dedicates five percent of the units toward workforce housing. It also requires more lower income units than required by the City’s current inclusionary requirement, which requires units affordable to households at 100% and 120% AMI.

Option 2: 20% Weighted Value BMR Units (Minimum 15% Actual BMR Units)

This option encourages more lower income units and assigns a value to these units. A home builder must meet a weighted value of 20% inclusionary housing and no less than 15% actual inclusionary housing units in the project.

Very low income units cost about the same to produce in mixed income housing project, but do not generate the same return on investment and are therefore, when provided, are more heavily subsidized. Non-profit home builders often use federal tax credits, local housing funds and other sources in order to build lower income housing units. The City’s local implementation of the state density bonus law also aligns this relationship between deeply subsidized units and the number of zoning waivers offered to developers when providing very low income units onsite. This option is generally guided by that principal and gives more weight to very low and low income units while less weight is given to moderate and workforce housing.

Table 2: 20% Weighted Value

	Income Level	Area Median Income	Weighted Value
Below Market Rate Units	Very-low Income	31-50%	1.9
	Low Income	51%-80%	1.2
	Moderate Income	81%-120%	.6
Workforce Housing	Above Moderate Income	121% - 140%	.3
Market Rate	Above Moderate Income	141% and above	0

A home builder may choose to toggle the number of units provided onsite based on a number of factors related to the density of the project, unit size, constraints of the site, length of holding, whether the units are for sale or rental, expected returns on costs, and a multitude of other considerations.

Below are several examples to illustrate this option. The first example is compared to Option 1; the others show other possible means of compliance.

Example 1: Option 2 Using Option 1 Inputs

	Income Level	Area Median Income	Weighted Value	% of Actual Units	Weighted %
Below Market Rate Units	Very-low Income	31-50%	1.9	5%	9.5%
	Low Income	51%-80%	1.2	5%	6%
	Moderate Income	81%-120%	.6	5%	3%
Workforce Housing	Above Moderate Income	121% - 140%	.3	5%	1.5%
Total				20%	20%

Example 2: Possible Compliance Inputs

	Income Level	Area Median Income	Weighted Value	% of Actual Units	Weighted %
Below Market Rate Units	Very-low Income	31-50%	1.9	3%	5.7%
	Low Income	51%-80%	1.2	12%	14.4%
	Moderate Income	81%-120%	--	--	--
Workforce Housing	Above Moderate Income	121% - 140%	.3	--	--
Total				15%	20.1%

Example 3: Possible Compliance Inputs

	Income Level	Area Median Income	Weighted Value	% of Actual Units	Weighted %
Below Market Rate Units	Very-low Income	31-50%	1.9	10%	19%
	Low Income	51%-80%	1.2	--	--
	Moderate Income	81%-120%	.6	--	--
Workforce Housing	Above Moderate Income	121% - 140%	.3	5%	1.5%
Total				15%	20.5%

Example 4: Possible Compliance Inputs

	Income Level	Area Median Income	Weighted Value	% of Actual Units	Weighted %
Below Market Rate Units	Very-low Income	31-50%	1.9	--	--
	Low Income	51%-80%	1.2	17%	20.4%
	Moderate Income	81%-120%	.6	--	--
Workforce Housing	Above Moderate Income	121% - 140%	.3	--	--
Total				17%	20.4%

Example 5: Possible Compliance Inputs

	Income Level	Area Median Income	Weighted Value	% of Actual Units	Weighted %
Below Market Rate Units	Very-low Income	31-50%	1.9	--	--
	Low Income	51%-80%	1.2	--	--
	Moderate Income	81%-120%	.6	34%	20.4
Workforce Housing	Above Moderate Income	121% - 140%	.3	--	--
Total				34%	20.4%

This option provides maximum flexibility to determine how to comply with the inclusionary requirement and, if elected, would tend to generate more low and very-low income units than would otherwise be produced – or a greater number of income restricted units if a developer chooses units in the moderate or workforce housing range.

Option 3: 10% Very-Low Income Inclusionary Housing and Plus Payment of Housing Impact Fees

Unlike the previous two options, staff proposes this option would only apply to rental projects – not ownership units. For sale units generally can support a higher inclusionary standard, but the yield on cost for a rental product is narrower. Therefore, the more inclusionary requirements imposed on rental housing, the more difficult it is to build. Moreover, most market rate home builders would prefer to pay a fee or, if inclusionary units are required, have the fewest number of restricted units. This option recognizes this interest and imposes a reasonable 10% inclusionary requirement for very low income housings units (50% AMI) and full payment of the housing impact fees. Using the weighting proposed in Option 2, this option is approximately equivalent to a 25% inclusionary requirement.

Payment of the housing impact fee will help restore the City’s housing funds, which are typically used by non-profit, low income housing projects. Non-profit housing typically also provides supportive programs that low income households can use to find jobs, help with school work, connect with social services and other programs; these services are not generally provided in market rate housing projects.

For a hypothetical 100,000 square foot rental housing project with 100 units, this option would result in 10 very low income units and payment of approximately two million dollars in housing impact fees.

Option 4: Off Site Housing

At least one developer has approached staff with the interest in providing the inclusionary units

offsite resulting in two projects, a 100% market rate development and, in conjunction, a 100% affordable housing development in a nearby location. Under this scenario, the units in the combined developments would still need to meet the necessary income level range, based on Council’s direction regarding the options above. Off-site compliance would be subject to similar requirements as those outlined in PAMC Sections 16.65.075 and 16.65.080 with respect to the equivalency of the units to those provided in the market rate development (i.e. the size, type, location of the units in the affordable housing development would need to be equivalent to those provided in the market rate development). Also, the affordable units would need to be available to the public before the market rate units are made available. Developers have expressed that allowing off-site development of the inclusionary units could allow them to not only finance the market rate development more easily, but also provide more BMR units than required as part of a 100% affordable housing development.

Unless otherwise directed, by Council, this option would be available to PHZ applicants.

Jobs / Housing Ratio

One additional requirement for a PHZ project is the need to provide more net new housing units than net new jobs created for a mixed use project. The purpose for including this discussion is to ensure staff and Council are aligned on how this factor will be determined for PHZ projects.

The Valley Transportation Authority Congestion Management Program provides information estimating the number of jobs per thousand square feet for different land uses.

Profession	Jobs/1,000 SF
Retail	1.75
Office	3.4
Hotel	2
Research and Development	2.5

To determine the number of housings units required for each job produced, staff would divide the number of jobs created by the number of employed residents per household. Most recent data on the number of employed residents per households comes from the American Census Survey from 2018 and for Palo Alto is 32,287 employed residents and 26,212 households. Accordingly, Palo Alto has an employed residents per household ratio of 1.23.

The following illustrates for a hypothetical project how many net new housing units would be required to off-set net new commercial jobs created:

Land Use	Total Floor Area	Jobs/1KSF	# of Jobs Created	Employed Resident/Household	# of Net New Housing Units
Retail	5,000 SF	1.75	1.75(5,000/1,000) = 8.75 jobs	1.23	7.11
Office	35,000	3.4	3.4(35,000/1,000) = 119 jobs	1.23	96.74
<i>Minimum Number of Net New Housing Units Required (rounded)</i>					104 units

Unless Council determines that different sources and ratios should be used, staff would use the above calculation to assess the minimum number of housing units required.

Policy Implications

Council’s decision may modify or otherwise clarify Council’s policy related to the PHZ and expectations for inclusionary requirements. This section summarizes how the options described above would help to address goals and policies identified in the Comprehensive Plan, Housing Work Plan, and Council’s expressed priorities.

Meeting Housing Needs of Palo Altans

In February 2020, the City Council selected Housing, with a focus on affordable housing, as a Council priority for the year. The Council heard from residents responding to an Open Town Hall Survey that housing was a top priority for residents. Likewise, the National Citizen Survey indicated that only 5% of Palo Altans rated the availability of quality affordable housing as excellent or good. By authorizing PHZs, the City Council seeks to address the needs of Palo Altans by encouraging property owners and home builders to construct housing projects. Insisting on a significant and meaningful proportion of inclusionary housing units, the Council seeks to ensure the new housing serves a wide range of Palo Altans. Under each of the proposed options, the Council can promote these goals.

Option 1 would assist the City in meeting it’s RHNA allocation at all income levels, including those at the deepest level of affordability as well as the workforce housing levels to address the “missing middle.” Option 2 provides flexibility to a home builder and places greater value on lower income units that would likely only be achieved through a non-profit housing development. Option 3 similarly places greater value on the lowest income levels while also collecting housing impact fees that could be used by a future non-profit organization to provide low income housing and supportive services.

All of these options are economically feasible based on analysis of a hypothetical project downtown and along El Camino Real. The options are presented as a menu for a home builder to choose, but the City Council may determine that one or more are not appropriate and direct

staff accordingly.

Comprehensive Plan & Housing Element

The City has issued building permits for 565 of the 1988 units identified under its RHNA allocation. To meet this goal, the City would need to permit an additional 1,423 units in the next two years. In addition, the City has an expressed Comprehensive Plan goal of producing between 3,545 and 4,420 new housing units from 2015 through 2030. The City is not on target to achieve this expressed Comprehensive Plan goal. An additional 343 units would need to be permitted each year to remain on track to meet its middle range housing production target.

Further, the California Housing and Community Development Department (HCD) signaled that the upcoming housing element cycle (2022-2030) will result in a higher regional housing needs assessment. The increased RHNA allocation will create more pressure for the City of Palo Alto to develop housing.

The City's ability to meet its above-moderate housing targets influences the level of affordability required for streamlined review, as mandated by the passage of SB 35 in 2017. Currently, qualifying housing projects that propose 50 percent of the units at low-income housing levels qualify for streamlined review because the City has not met its targets in the past for providing units at the low and very-low income levels. If the City does not meet its above-moderate numbers by 2022, streamlining will apply to projects with 10 percent on-site affordability.

Resource Impact

This report transmits options for Council's consideration regarding inclusionary requirements for housing projects proposing a planned home zoning change. Council's direction would not have a direct resource impact on the City. Council's direction would provide clarity, streamlining staff time in processing future applications.

Stakeholder Engagement

Staff has participated in conversations with approximately a dozen developers interested in pursuing projects under a PHZ. Overall, Council's consideration of PHZs has stirred interest; however, developers have requested greater clarity on expectations before pursuing projects further.

Environmental Review

This project is exempt from the California Environmental Quality Act (CEQA) under State CEQA Guidelines Section which 15061(b)(3) because it can be seen with certainty that the proposed action will not have the potential for causing a significant effect on the environment. The city would evaluate any future proposed development in accordance with CEQA.