



# City of Palo Alto

## City Council Staff Report

(ID # 11876)

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**Report Type: Action Items**

**Meeting Date: 4/12/2021**

**Summary Title: PHZ Update**

**Title: Update on the City's Planned Community (Planned Home Zoning - PHZ) Application Process and Possible Council Direction for Changes Related to its Implementation, Criteria and Applicability Citywide**

**From: City Manager**

**Lead Department: Planning and Development Services**

### **Recommendation:**

Staff recommends that Council discuss the Planned Home Zoning application process and provide direction to staff as appropriate.

### **Background:**

On February 3, 2020, the City Council reauthorized the use of Planned Community zoning for housing projects, including mixed-use projects.<sup>1</sup> Planned Community zoning is authorized in accordance with Palo Alto Municipal Code (PAMC) Title 18, Chapter 38 and intended to facilitate unified, comprehensively planned developments that provide a substantial public benefit and enhance the policies and programs of the City's Comprehensive Plan. The City Council previously suspended use of the Planned Community zoning around 2014 out of concern that the public benefits the City was receiving were not aligned with the value conveyed to (mostly commercial) developers for changes in local zoning standards.

Following adoption of the City's Comprehensive Plan in 2017, a Housing Work Plan in 2018, changes to the municipal code and several colleagues' memos – all prepared, in part, with the intent to spur more housing production – the City Council enabled Planned Community zoning for housing projects that met two public benefit criteria: 1) At least twenty percent of the housing units would be deed restricted for below market rate housing units, and 2) More housing units would be provided than needed to accommodate net new jobs created by the

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<sup>1</sup> Council Report, dated February 3, 2020 introducing PHZ concept:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=61922.54&BlobID=74930>

development. In exchange for meeting these criteria, a home builder could seek relief from certain zoning standards, typically height, floor area, parking, lot coverage, and setbacks. The program was informally renamed Planned Home Zoning (PHZ) but follows the same procedural requirements of a Planned Community project.

Over the past year, the City Council has reviewed PHZ prescreening requests for three properties: two on El Camino Real and one on Fabian Way.<sup>2</sup> A prescreening is a necessary first step an applicant must take prior to filing a formal application. City staff does not have the authority to refuse or decline to process any prescreening application. A noticed public hearing before the City Council is required when filed.

The three PHZ prescreening applications considered to date included 593 net new housing units. Three additional prescreening applications are pending for another 125 units. Staff conversations with other potential applicants suggests interest in another ~350 housing units in Downtown, along El Camino Real, and other locations.

The City's Comprehensive Plan anticipates the City will add about 4,000 housing units from 2015-2030, or about 267 housing units per year.<sup>3</sup> Since 2015, the City has averaged 122 net new housing units per year; accessory dwelling units make up twenty-three percent of those units. As part of the Housing Element update required by state law, it is anticipated the City will need to plan for more than 6,000 units over the next housing cycle.

As previously reported and in accordance with state senate bill 35 (SB 35), the City (and other jurisdictions) are subject to state mandated application streamlining requirements when it fails to issue building permits for its regional housing needs allocation (RHNA) for either low income or market rate units. At present in Palo Alto, a housing project would be eligible for streamlined administrative review (no architectural review) if a housing project is at least two-thirds residential, restricts fifty percent of the units to low-income households, and meets other state requirements. The required on-site below market rate unit proportion falls to 10% if the City fails to meet its market rate housing production. The City has consistently met its market rate RHNA targets and is expected to do so again for the current housing cycle. However, for the upcoming RHNA cycle (2023-2031), without significant land use policy adjustments to local zoning, meeting the anticipated market rate housing targets will be challenging.

Following the study session discussions on the three previously reviewed PHZ applications, one developer has declined to proceed with the housing component and filed an application to

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<sup>2</sup> 3300 El Camino Real Prescreening Council Report, dated June 22, 2020:

<https://www.cityofpaloalto.org/civicax/filebank/blobdload.aspx?t=73113.28&BlobID=77258>

2951 El Camino Real City Council Staff Report, dated January, 19, 2021:

<https://www.cityofpaloalto.org/civicax/filebank/documents/79814>

3997 Fabian Way Prescreening Council Report, dated February 8, 2021

<sup>3</sup> The housing range provided in the Comprehensive Plan is 3,545 – 4,420 units.

build an approximately 52,800 square foot office building. Another home builder is expected to file a formal PHZ application for PHZ. The third owner anticipates requesting another prescreening opportunity before the City Council. All pending prescreening applications have been stayed temporarily pending the Council's discussion but are expected to resume shortly.

The PHZ application process was intended to stimulate more home building and inform the City about land use regulations that may constrain housing production. There are many factors a property owner considers when redeveloping property including how long it has been under their ownership, the cost to acquire the land, existing and forecasted revenue projections, hard and soft construction costs, time, risk, experience, and a multitude of other variables. The City's zoning regulations have not enabled the amount of housing the Comprehensive Plan envisions despite recent amendments to encourage home building. In conversations with potential developers, the City's Housing Incentive Program (HIP), which eliminates density restrictions, removes lot coverage constraints, and increases a site's floor area ratio, were viewed as a positive step, but it has not resulted in any meaningful housing production. One exception, however, is a recent 102-unit housing project approved by the City Council that included extending the HIP along San Antonio Road where it did not previously exist.

The PHZ application is not and was never intended to be a long-term solution or alternative to fixed zoning standards. The application process is too long for many developers, carries a fair amount of risk, and lacks predictability. Many community members also object to the uncertainty it creates for them and concern that the property next door can be redeveloped with a building that is taller or more massive than otherwise allowed under existing zoning rules. PHZ applications do have value though in other respects. This application type has (along with previous development agreement applications) generated approximately 2,100 housing units over the past two decades.

Recent PHZ applications also provide information about the type of development standards that appear to constrain housing development. While more information is needed, clearly incremental increases to height and greater floor area are often cited as limitations. Financing is another factor. Many developers have expressed a need to retain (rebuild) or add net new office floor area to help pay for the residential units. Some owners are unwilling to forgo office rents in favor of a housing project and will not file a PHZ application. Owners that are willing to consider a housing project instead of office are likely to ask for a greater deviation from the code to make up for the opportunity cost for not providing office. The first three prescreening applications illustrate this challenge and at least two other potential PHZ applications seek to add net new office or retain what is already existing. Based on this City's experience after one year, evolving Council perspectives, and community feedback on some pending PHZ applications, the City Council requested staff schedule this PHZ update to consider whether additional parameters are needed to provide some certainty to residents and set clearer expectations to prospective applicants regarding the limits of the PHZ application process.

## **Discussion:**

The City Council has the authority to discontinue or modify the PHZ program at any time. Staff recommend the Council continue to accept applications to learn more about zoning constraints and to facilitate more housing production. While there may be different perspectives about the appropriateness of the PHZ applications presented thus far and some pending applications, there is the potential for other more modest applications depending on how the Council may want to modify the program. Some of the topics the City Council may want to provide additional guidance on are summarized below.

When considering the topic areas below, it is important to remember that the City Council has very broad discretion to approve or deny any formal PHZ application. These applications include a legislative component and the City Council, as the City's legislative body, has the exclusive decision-making authority (short of an initiative or referendum) to approve or deny any request.

### Location Criteria

While not explicitly stated in the staff report or Council minutes on February 3, 2020, the expectation was that PHZ applications would be filed in commercial zones. References to the HIP, efforts to improve the jobs/housing balance, and statements that redevelopment would likely occur in commercial areas underscore that intent. However, there also was no explicit restriction advising owners that the City would not consider a PHZ on a low-density, residentially zoned parcel. A pending PHZ application for a property located in College Terrace and zoned R-1 has generated a significant amount of correspondence to the City Council mailbox. As noted earlier, staff is unable to reject or fail to process prescreening applications, but staff did advise the prospective applicant that the proposed PHZ application was not consistent with the intent of this program.

The City Council in its discussion may want to clarify its interest in considering PHZ applications for R-1 and low-density zoning. The Council this year reviewed one PHZ application that was principally located on commercially zoned property but did include two adjacent R-1 zoned parcels in the North Ventura Coordinated Area Plan area. The bulk of the housing density, however, was located on the commercially zoned properties. Going forward, staff recommends PHZ applications be considered for all commercial, industrial zoning, and multifamily districts.

### Height

Recent Council feedback suggests some willingness to exceed the 50-foot height by approximately 10% or, where adjacent buildings are taller, not exceed the height of those neighboring buildings. Many developers are interested in taller buildings up to 60 feet or more. While there is some appeal in establishing a defined number, staff recommend the Council

allow for some flexibility to respond to neighborhood context where additional height above 10% may not be impactful, such as some areas in Downtown or areas that are not in close proximity to sensitive land uses, such as the R-1 district or low-density zoning. Often the additional height not only increases the number of units that can be built it also increases the value of the project making it more financially feasible and thus more likely to be built.

#### Floor Area Ratio

Similar to height, a project's floor area ratio requires consideration of the context in which a potential project is being proposed. The HIP allows for a 1.5 FAR along El Camino Real, but the City's affordable housing and workforce housing overlay allow up to 2.4 FAR. Two recent PHZ projects on El Camino Real contemplated FARs of 1.79 and 2.55. Downtown the HIP allows up to a 3.0 FAR. With the PHZ, a prospective applicant may request a greater FAR, but staff and the City Council would be in a position to offer comments to reduce FAR if it is perceived too great. Given the number of variables and contextual unknowns, staff again recommend some measure of continued flexibility in order to encourage more housing production.

#### Twenty Percent (20%) Inclusionary Housing Requirement

This provision is one of the substantial public benefits PHZ applications provide in exchange for changes in local zoning regulations. This inclusionary standard is greater than the current 15% requirement in the code. It also has the potential to provide a greater diversity of deed restricted income units, including low and very low income and missing middle workforce housing. The City Council reviewed a market feasibility study<sup>4</sup> in September that documented some of the challenges that arise when more deed restricted housing units are embedded in market rate development. Unless the underlying zoning standards permit greater development incentives to help offset the cost of the affordable units, it is unlikely there will be any significant new housing production with or without income restriction units.

In June 2020, the City Council endorsed four options<sup>5</sup> that a prospective PHZ applicant could use to satisfy the 20% inclusionary requirement. During its review of previous PHZ applications, some councilmembers have articulated the 20% inclusionary requirement was too low and did not satisfy the desired income levels. Staff does not recommend increasing inclusionary requirements and there may be some argument to reduce the standard to 15% especially if the Council is concerned about the size of recent PHZ housing projects.

If, however, there is an interest to increase the number beyond 20%, the City Council may want to consider this additional amount be dedicated toward deed-restricted workforce housing

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<sup>4</sup> Market Feasibility Study to Increase BMR units from 15% to 20% and Extend to Rental Housing, dated September 21, 2020: <https://www.cityofpaloalto.org/civicax/filebank/documents/78377>

<sup>5</sup> PHZ Inclusionary Options and Jobs/Housing Report, dated June 23, 2020: <https://www.cityofpaloalto.org/civicax/filebank/documents/77352>

units. These units serve households with incomes between 120% and 150% of the County's area median income level. Depending on the size of units (number of bedrooms), rents and allowable sales prices for these units can equal market rates, which allows a developer to cover the cost of the unit. By being income-restricted, the rental and sales prices for these units grow more slowly over time, preserving housing for moderate income families. These units can be particularly important for teachers, first responders, and others who earn competitive wages, but remain priced out of Palo Alto.

### Office Component

Staff has had several conversations with prospective PHZ applicants and office space is often a component in conceptual site planning. Generally, sites with existing office will likely include a request to at least rebuild/replace existing area and add housing. Some property owners are interested in a net increase in office either because the underlying zoning permits office development or to help make the housing project more feasible. To encourage a property owner to build housing with inclusionary units where office is allowed by right, the City's housing incentives must be significant enough to support that financial decision. For this reason, many PHZ applications on commercial property are likely to include an office component.

In one prescreening application, the applicant proposed a code compliant office project with a 0.4 FAR and a PHZ request for a 1.39 FAR housing component with 190 housing units (38 affordable units). In this instance, the applicant was unwilling to forego projected office revenue for a one hundred percent housing project. The Council in 2020 was mixed in its non-binding comments and the applicant dropped the residential component. Today the City is processing an architectural review application for a new 52,800 square foot research park office building.

The City has a number of policies that limit office development, including a 50,000 square foot annual office cap, a citywide cap on office and research/development through 2030, and a retail preservation ordinance that restricts the conversion of ground floor retail and retail-like uses to office. If the City Council desires to further reduce the office component of PHZ applications, it could consider a standard that requires 2/3rds of the gross floor area to be dedicated toward housing or make changes to the jobs/housing criteria. However, reducing or eliminating office from PHZ applications is expected to reduce the number of applications filed.

### Jobs Housing Balance

The same night Council endorsed the four inclusionary options it also accepted the staff recommended approach for determining the number of housing units needed to offset net new job creation. The model uses estimates from the Valley Transportation Authority Transportation Management Program to determine the number of jobs generated per one thousand square feet based on generalized job classifications.

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 table was provided in the June 2020 staff report to illustrate 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>					<b>104 units</b>

At a recent PHZ prescreening study session, at least one Councilmember suggested it may be appropriate to reconsider the above approach. The above model does not take into consideration additional jobs generated to support the net new increase in commercial jobs. For example, a new employee may also patronize local restaurants, need services for their home, and generate demand for other local jobs. Staff recommend the City Council consider the above jobs/housing criteria, which is intended to serve as a second substantial public benefit to approve a PHZ application and one that serves to improve the City’s jobs/housing balance.

**Policy Implications:**

The PHZ process is intended to spur housing production by providing incentives that encourage more home building and less office development to address the City’s housing needs and improve the City’s jobs/housing imbalance. Housing production in Palo Alto is not keeping up with local policies set forth in the Comprehensive Plan or state targets provided through the RHNA process. The PHZ has been available to property owners for about 14 months and has spurred significant interest and several prescreening applications. Many in the community have expressed concerns about the PHZ process and some Councilmembers noted an interest in making program refinements.

To the extent more is required of home builders, such as more inclusionary units or less office space, this direction will impact the number of PHZ applications the City receives. While the City is expected to meet the market rate housing targets for the current housing cycle, it will be a challenge to meet these targets in the upcoming housing cycle without significant local land use

policy changes to spur more housing production. Increasingly the state legislature has sought to compel home building solutions on local jurisdictions in ways that may not align with community interests. The PHZ process is one way the City can exercise its local control over zoning and eventually establish clear, objective regulations that will enable the City to meet its housing needs.

**Resource Impact:**

There is no significant fiscal or budgetary impact associated with this recommendation.

**Timeline:**

Depending on the direction received, some action taken by Council can be implemented immediately; any legislative changes directed by Council would likely require review before the Planning and Transportation Commission and require time to prepare and prioritize relative to other department efforts.

**Stakeholder Engagement:**

Notice of this discussion was provided on the meeting agenda and published online.

**Environmental Review:**

The recommendation does not qualify as a project in accordance with the California Environmental Quality Act.