# The Grand Nexus Study

A Collaborative Effort to Study Residential and Commercial Impact Fees to Support Affordable Housing in San Mateo County

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## Credits and Acknowledgments:

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And all participating jurisdictions


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## ADVANTAGES OF COOPERATION

- Less expensive
- Better policy
- Stronger legal grounds
- Safety in numbers
- More funding for affordable housing
- Predictability and consistency make for a better development climate

# Jurisdictions Participating in the Study

## What is 21 Elements

21 Elements is an award-winning collaborative planning project that helps all the jurisdictions in San Mateo County address their housing needs.

Co-sponsored and coordinated by the San Mateo County Department of Housing (DOH) and the City/County Association of Governments of San Mateo County (C/CAG), 21 Elements has successfully brought together twenty-one unique communities and assisted them as they work to address the challenges of providing a variety of housing choices.

## Grand Nexus Study Background

Across the Bay Area, housing prices are continuing to rise, making it necessary for many to live far from their work and communities. With average sale prices nearing one million dollars and rents increasing faster than wages, there is an ever growing need for affordable housing.

Recent policy changes have also contributed to the growing interest in new strategies that promote affordable housing. Redevelopment agencies, the primary funding source for affordable housing at the local level, were eliminated because of adjustments to State law. Additionally, a jurisdiction's ability to require affordable units in new rental housing -- a practice called *inclusionary zoning* -- was restricted due to the 2009 Palmer Sixth Street Properties v. City of Los Angeles lawsuit. As a result, most jurisdictions in San Mateo County have embarked on a path to address their affordable housing needs in a coordinated manner.

One strategy that is of particular interest to jurisdictions is charging fees on new development to pay for affordable housing. Before a city can do this, they must conduct a study to understand the existing real estate market and how new construction will increase the demand for affordable housing.

Typically, interested cities would individually hire a consultant to undertake this work, which can cost up to $90,000 in consulting fees. Through the 21 Elements collaboration process, 15 San Mateo County jurisdictions and the City of Palo Alto hired one consultant to produce studies for each city. This project, which came to be known as the Grand Nexus Study, reduced costs by 75 percent and helped to establish best practices.

Customized, jurisdiction-specific reports focusing on local conditions were completed and provided to each participating city in the second half of 2015. Some cities have already adopted new fees based on these studies. The remaining jurisdictions are now considering next steps based on their local policy needs.

21 Elements has become a model for cities across the state, including other jurisdictions in the San Francisco Bay Area. Santa Clara and Alameda Counties are currently working with the Silicon Valley Community Foundation to duplicate the Grand Nexus Study approach and create a similar forum in their counties. We are excited to share our experience so that any city can use this tool to increase funding for affordable housing, and help to address unmet needs in their communities.

### 21 ELEMENTS APPROACH

- Collaborate and benefit from a more regional planning perspective
- Maintain local control in carrying out policies
- Save time and money through economies of scale
- Value greater stakeholder engagement
- Strengthen local partnerships
- Provide expert assistance and share best practices
- Enable implementation of more coordinated and better policies

# Impact Development Fees Explained

### What are Impact Fees

Impact fees are charges imposed by jurisdictions that can be used to support and build new development. Since the 1970s, California cities have used impact fees to help pay for items like roads, parks and schools. Fees can only be applied to new development projects, and cannot be used for existing problems. Before being adopted, jurisdictions must show that there is a connection between the impacts caused by development and the fees charged.

### What is an Affordable Housing Nexus Study?

A *nexus study* assesses the impact of new development on the need for new affordable housing. This is accomplished by calculating the number, type and salaries of jobs that will result from a new development. The connection a study identifies can be direct, such as employees in an office park, or indirect, such as the jobs needed to serve new residents living in new market-rate housing. The study then establishes the maximum impact development fee that can legally be charged to a developer.

The logic behind a housing impact fee nexus study is that residents of new housing spend money on goods and services like landscaping, child care, restaurants, etc. Many of the workers at these businesses earn lower wages, and cannot afford to buy or rent a home at market-rate. Because the housing market does not provide housing that is affordable to these workers, local governments often step in to fill the gap by facilitating the construction of affordable housing. A residential nexus study examines and quantifies this relationship. Similarly, a commercial nexus study examines the incomes of new workers employed by new commercial development and their housing needs.


### How to Determine if a Fee is Feasible

While a nexus study will inform a jurisdiction about the maximum amount they can legally charge as an impact fee, the maximum fee level may not be appropriate given local housing market conditions, existing fee levels in the region or the jurisdiction's current fee structure. A *feasibility study* considers these conditions and recommends an impact fee that does not interfere with the economic feasibility of new development. While not required, feasibility studies are highly recommended.

## IMPACT FEE BASICS

- Nexus Study determines max legal fee
- Feasibility Study sets appropriate fee based on local economic conditions
- Commercial and/or residential fees can be set per square foot, per unit or other measures
- Often an Important part of a community's Affordable Housing Development Toolkit

### The Growth of Housing Impact Fees

Many jurisdictions across the country and throughout the Bay Area region have shifted toward the use of impact fees to increase affordable housing opportunities. Several Bay Area cities, including Daly City, Fremont, Mountain View, Menlo Park, Redwood City, San Carlos, San Francisco, Santa Rosa and Walnut Creek, have established residential and/or commercial housing impact fees. For instance, Redwood City recently approved charges between $20 - $25 per square foot for new residential development (varies based on type of development) and $20 per square foot for new commercial office development. These fees are expected to generate $3 million per year for the city, which will be deposited into their housing trust fund.

Many other cities are currently in the process of designing or updating their impact fee programs to respond to the growing affordable housing needs in their communities. Beyond the San Mateo County effort, approximately twenty jurisdictions in Santa Clara and Alameda Counties are currently undertaking or have previously completed housing impact studies.

# Impact Development Fees Process

## FAQs About Housing Impact Fees

### Will Housing Impact Fees Increase Housing Prices or Rents?

Shelterforce Magazine recently published an article on this topic and concluded, "No, they do not." The article continues to say, "Market-rate developers are business people. They charge as much as the market will bear. When housing prices go up, they charge more; when housing prices go down, they ask less. Developers are "price-takers" not "price-setters" because they only control a tiny share of the housing market. A large majority of rental and for-sale housing is located in existing buildings, not in brand-new buildings, limiting the influence of new housing, and [affordable housing] requirements, on home prices."

While this is true almost everywhere, it is especially true in San Mateo County. The real estate market is very competitive and builders here know the market very well. Before they decide to build, they conduct extensive research to understand how much potential buyers or renters will pay. Home buyers and renters are also very knowledgeable. They compare new and existing homes across multiple jurisdictions to find the best deal, and take their decision seriously because housing prices are so high. Homebuyers are only willing to pay what they think a new home is worth, which is solely based on all the other homes currently on the market, not costs incurred by developers.

It is not just economic theory that says home prices are primarily determined by the existing market, but also numerous California specific studies have found that affordable housing policies like impact fees, do not affect prices.

### Will Housing Impact Fees Stall Development and Negatively Impact Housing Supply?

No, as long as the fee levels are set at the appropriate level. From an economic perspective, housing impact fees operate similarly to inclusionary zoning, which has been in place throughout the country for decades. Inclusionary zoning requires developers to provide a certain percentage of new housing units in their development at below market-rate affordability levels. A 2008 analysis of Bay Area housing policy by the Furman Center for Real Estate at NYU found that inclusionary programs have no impact on housing production or price. If fees are set at a moderate and appropriate level for the local economy, developers will still be able to purchase land and meet their expected profit. Local examples confirm this finding. The cities of Cupertino and Menlo Park — with new Apple Computer and Facebook headquarters — both charge impact fees and continue to attract new development. The City of Mountain View, as another example, has seen no decrease in interest from rental housing developers since passing its rental impact fee in 2012.

However, a poorly designed program, with fees set too high, does have the potential to impact the feasibility of new development. This is why it is important to conduct a feasibility study so that fees can be set at realistic levels. Doing so ensures continued new development that not only provides new housing, but also contributes to funds that make increasing affordable housing possible.

## The Grand Nexus Study

In 2014, fifteen San Mateo jurisdictions and Palo Alto, coordinated by 21 Elements, jointly hired Strategic Economics and Vernazza Wolfe, Inc. to prepare nexus and feasibility studies for each city and San Mateo County. **This effort has been called the Grand Nexus Study since it involves multiple jurisdictions, covers both residential and commercial development, and looks at feasibility as well as the legally required nexus analysis.** The impetus behind this effort was the growing concern about the need to identify a funding source for new affordable housing. By studying the relationship between new development and how much affordable housing is needed for new lower income workers, new housing impact fees were calculated.

Studies were customized for each jurisdiction, including market data, demographic information and feasibility analysis. Each city received two separate studies: one for residential development and a second for commercial development. When making recommendations, the consultants also ensured that if a city adopts both a residential and commercial fee, the impacts will not be double counted.

### Importance of Conservative Assumptions

When preparing nexus studies and feasibility reports, a number of estimates need to be calculated. The Grand Nexus Study used conservative assumptions for these calculations whenever possible. Doing so resulted in a lower estimate of the maximum nexus-supported impact fee that could legally be charged to new development. For instance, because there had been little new housing development completed in San Mateo County before 2014, the sale prices and rental rates used in the study were often several years old. While new projects will probably have significantly higher prices and rents, lower cost assumptions built in a cushion in case of an economic downturn in the future. Similarly, a lower range of land and construction cost were used to estimate development costs. As a result, feasibility report recommendations include a safety margin to assist policymakers in arriving at jurisdiction-specific fees that are legally appropriate and implementable.

### Steps of the Study

The first step for jurisdictions when beginning either a residential or commercial nexus study is to **identify what type of development to study**. Residential studies can include single-family detached homes, condos, townhouses and apartments. Commercial studies can include offices, retail, restaurant/services and hotel.

Once the type of development to be studied has been established, residential and commercial studies will **estimate future conditions and impacts based on conservative assumptions**. For a residential study, the annual household income of buyers and renters is first estimated. The economic impact they will have is then calculated, including jobs and wages linked to household spending. Finally, the number of new worker households and annual incomes that are expected is determined.

For a commercial study, the number of workers that will work in newly developed commercial space is first estimated. The number of homes needed for these new workers is then calculated, followed by their projected wages and annual household incomes.

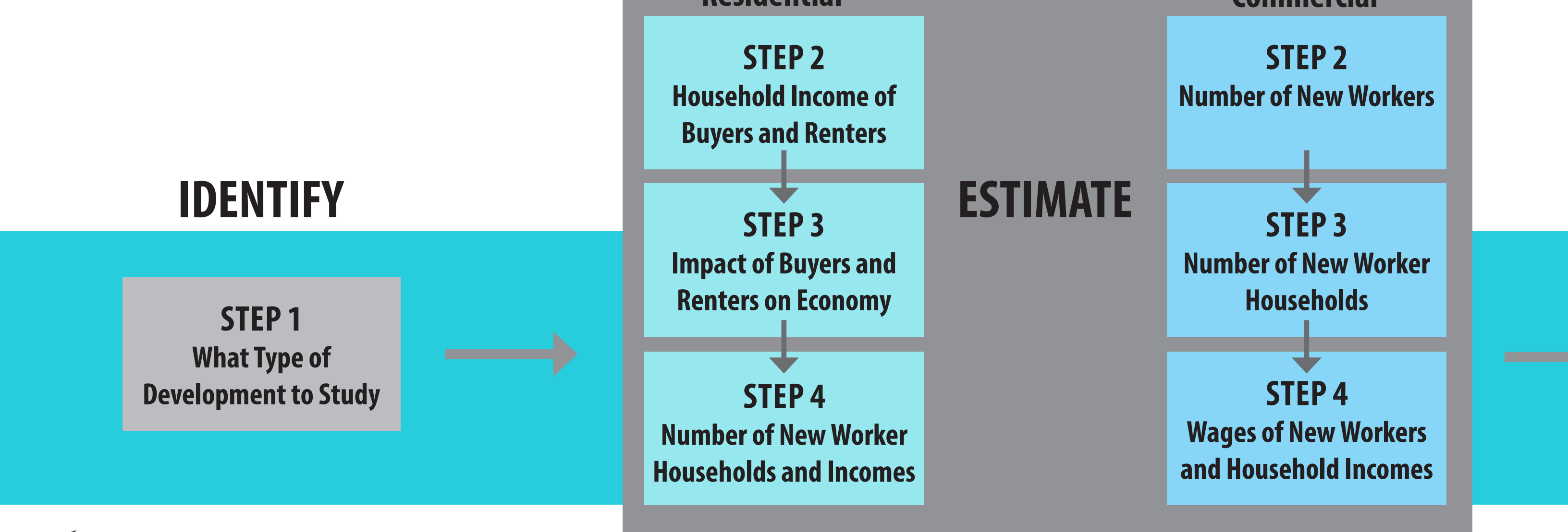
Once estimates are completed, both residential and commercial studies will **calculate the number of workers eligible for affordable housing**, or the demand for affordable housing, by very low, low, and moderate incomes.

The final step residential and commercial studies take before arriving at maximum nexus-supported impact fees is to **calculate the affordability gap - the difference between what households can afford to buy or rent, and the cost of building a new unit**.

### Study Results

Results varied based on the real estate market conditions in each city, and the existing costs of fees and permits charged on new development. Cities with strong markets often have higher recommended fees, while cities with moderately strong markets

## The Nexus Study Process



generally have lower recommended fees for the same type of development. The range of recommended fees are shown in the table below, as is a comparison of existing impact development fees of cities across San Mateo and Santa Clara Counties.

## Feasible Recommended Fees

| | Single Family | Condo | Apartment | Office | Retail |
|---|---|---|---|---|---|
| **Jurisdiction 1** | 40.00 - 50.00 | 25.00 - 50.00 | 25.00 - 50.00 | 5.00 - 10.00 | 2.50 - 7.50 |
| **Jurisdiction 2** | 25.00 - 35.00 | 10.00 - 25.00 | 10.00 - 25.00 | 5.00 - 20.00 | 2.50 - 7.50 |
| **Jurisdiction 3** | 20.00 - 35.00 | 15.00 - 25.00 | 15.00 - 40.00 | 20.00 | 5.00 |
| **Jurisdiction 4** | 35.00 - 40.00 | 5.00 - 15.00 | 5.00 - 10.00 | 25.00 - 40.00 | 5.00 - 10.00 |
| **Jurisdiction 5** | 15.00 - 20.00 | 25.00 - 35.00 | 15.00 - 25.00 | 5.00 - 10.00 | 2.50 - 7.50 |

Names of jurisdictions have been omitted at this time. Some reports have yet to be finalized or made public.

## Impact Development Fees of San Mateo and Santa Clara County Cities

| | Single Family | Condo | Apartment | Office | Retail |
|---|---|---|---|---|---|
| **Cupertino** | 16.50 | 20.00 | 25.00 | 20.00 | 10.00 |
| **Daly City** | 18.00 | 22.00 | 25.00 | N/A | N/A |
| **East Palo Alto** [a] | N/A | 22.00 - 44.00 | 22.00 | N/A | N/A |
| **Menlo Park** [b] | N/A | N/A | N/A | 15.19 | 8.42 |
| **Mountain View** [c] | N/A | N/A | 15.00 | 25.00 | 2.50 |
| **Redwood City** | 25.00 | 20.00 | 20.00 | 20.00 | 5.00 |
| **San Carlos** [d] | 21.00 - 42.00 | 21.00 - 42.00 | 24.00 - 43.00 | N/A | N/A |
| **Sunnyvale** [e] | N/A | N/A | 17.00 | 15.00 | 7.50 |

a. 25.00 per sq. ft. for housing without structured parking and 44.00 per sq. ft. for housing with structured parking
b. Commercial buildings 10,000 sq. ft. and under exempt from fees.
c. New gross floor area under 10,000 sq. ft. discounted 50% of fee for office and retail
d. Range based on number of units
e. First 25,000 sq. ft. discounted 25% of fee

### What Options Do Jurisdictions Have?

City and County jurisdictions have several options if they decide to establish or update their housing impact fees. The first major policy choice is whether to charge impact development fees on residential development, commercial development or both. The second major policy choice is whether or not to use inclusionary zoning for ownership units.

There are many detailed policy options to choose from as well. Cities can charge impact development fees by the square foot or per unit, create size thresholds so that fees only apply to developments over a specific size, or allow developers to provide affordable housing on- or off-site. Jurisdictions can provide discounts depending on the type of development, such as developments using prevailing wage labor or predominately local workers. Jurisdictions can also place all or a portion of collected impact fees into a countywide pool of funds. Doing so can potentially leverage resources and achieve an even greater number of new BMR affordable units. A jurisdiction has many options to consider based on what works best for its local market conditions and housing strategies. 21 Elements has resources for interested cities and counties.

## CALCULATE

**STEP 5**
New Demand for Affordable Housing

→

**STEP 6**
Subsidies Needed to Build Affordable Housing

→

**STEP 7**
Maximum Nexus Fee

# Impact Development Fees:
## what is possible in San Mateo county

Exactly how much money could be generated if every jurisdiction in San Mateo County established housing and commercial impact fees?

To answer this question, conservative impact fee assumptions were made for **all currently proposed countywide development**. Residential units were given a hypothetical housing fee of $20,000 each. For commercial fees, office was set at $20 per square foot, and retail and hotel were set at $5 per square foot each.

**Proposed Countywide Development x Assumptions = Possible Impact Fees**

| | | |
|---|---|---|
| 8,011 residential units | @ $20k a unit = | 160,220,000 |
| 15,033,200 square feet of office | @ $20 per/sq ft = | 300,664,000 |
| 495,000 square feet of retail | @ $ 5 per/sq ft = | 2,475,000 |
| 1,691 hotel rooms | @ $ 5 per /sq ft = | 7,482,675 |
| | | $470,841,675 |

# More than $470 Million

**in impact development fees could be generated in San Mateo County.**

Source: Development on the Peninsula, San Francisco Business Times, August 28, 2015. Supplemented by private communication with city staff. Hotels average one room per 885 sf, per nexus studies.

# Policy Considerations

While the Grand Nexus Study provides the necessary economic analysis jurisdictions need before considering what fees to set, it is up to policymakers to decide what percentage of the maximum fee should be charged on new development. It is recommended that cities considering housing impact fee programs keep in mind four factors to ensure new policies do not negatively impact new development:

- **Feasibility:** At what level should housing impact fees be set, considering a city's current and expected housing and commercial markets?
- **Existing Fees:** What is the total amount of fees that are currently being charged for new development, and what would the total be with new impact fees?
- **Neighboring Jurisdictions:** What are the fees currently being charged by other cities in a region?
- **Affordable Housing Objectives**: What goals does the community have regarding affordable housing and how do impact fees fit into the overall strategy?

**For more information visit:**
**21elements.com**