



CITY COUNCIL AGENDA REPORT

DATE: January 5, 2024

AGENDA OF: January 23, 2024

DEPARTMENT: Planning & Community Development and Economic Development & Housing

SUBJECT: Impact Report on the Effect of the Proposed Housing for People Initiative (Measure M) (PL/ED)

RECOMMENDATION: Accept the impact report on the effect of the proposed Housing for People initiative (Measure M) and, should the Council choose to do so, vote to take a formal position on the measure.

BACKGROUND: On October 24, 2023, the City Council provided direction to prepare a report on the Housing for People initiative (Measure M), including an analysis of relevant information in California Elections Code Section 9212 and as described in the October 24, 2023 agenda report attached hereto. Council directed that the impact report be presented to Council no later than the February 13, 2024 hearing to allow for timely distribution and discussion prior to the March 5, 2024 election day. Council also directed that staff may seek assistance from a qualified consultant in preparing the impact report.

In response to Council direction, staff issued a Request for Proposals and selected Keyser Marston Associates (KMA) to prepare the report. The impartial analysis prepared by Keyser Marston is attached.

DISCUSSION: Measure M would amend the City's Municipal Code to prohibit the City Council from amending the City's General Plan or Zoning Ordinance in a way that increases allowable height limits or floor area ratios (FARs)¹ for development projects in any zoning district without a prior vote of the people. The measure would also increase the City's inclusionary housing requirements to at least 25% for developments with 30 or more units. The following conclusions are explicitly made or derived from KMA's analyses. KMA's full analysis contains the detailed explanations and evaluation leading to the conclusions below, and in some instances, additional information is also provided later in this staff report.

¹ FAR is a measure of how much square footage is constructed or allowed on a site as compared to the square footage of the site itself.

Summary of Conclusions from KMA's Analysis of Measure M

1. Measure M has Broad Applicability
 - a. Measure M applies citywide in all Zoning Districts and to all General Plan Designations.
 - b. The measure would necessitate voter approval for a broad range of changes to the Zoning Ordinance, Zoning Map, General Plan, or General Plan Land Use Map, when said changes result in increased FAR or height allowances but not limited to direct changes to FAR and height, because changes to regulations such as setbacks, building separations, lot coverage, or number of stories could require voter approval.
 - c. The voter approval noted above would potentially impact a broad range of projects, including but not limited to 100% affordable projects, single-family homes, accessory dwelling units (ADUs), fences, commercial buildings, industrial buildings, mixed-use projects, and public buildings.
2. Measure M will Constrain Housing Supply
 - a. The inclusionary requirements in Measure M will reduce affordable housing production and market rate housing production.
 - b. KMA evaluated rental and ownership housing projects, and neither development type was feasible at a 25% inclusionary rate, including when considering the State Density Bonus Law.
 - c. Measure M increases developer risk when a vote is required. A vote results in additional time, additional costs, and increased uncertainty, each of which will discourage development.
 - d. Measure M would make it more challenging to meet the City's Regional Housing Needs Allocation (RHNA) targets from the State, which, if not achieved, has a range of implications, including a loss of local land use control through California Government Code 65913.4 housing development application streamlining requirements (Senate Bill (SB) 35 legislation).
3. Measure M would Constrain the City's Ability to Comply with State Law Requirements
 - a. Measure M's inclusionary housing requirements are confiscatory, deprive property owners of a fair and reasonable return on their investment, and act as a constraint to housing, all of which conflict with State law and associated case law.
 - b. When the City is not meeting its RHNA targets, the City's State-certified Housing Element calls for the City to take additional actions to promote housing production, and Measure M would make it more challenging to enact those changes, as some of those actions would require voter approval under Measure M.
 - c. The Housing Element also calls for a range of additional actions that would or could trigger voter approval, meaning that it will be more time consuming, more costly, and more uncertain as to the outcome.
 - d. If the City is not enacting policy changes required by its Housing Element, the State can decertify the City's Housing Element, which has a range of implications, such as reduced funding for affordable housing and housing development projects being able to ignore local land use laws.
 - e. Measure M would make it more challenging to change City rules to comply with State legislation, as State legislation would routinely require a vote of the people.

4. Measure M has a Significantly Negative Fiscal Impact
 - a. Each ballot measure currently costs the City and taxpayers between \$115,000 and \$185,000.
 - b. Measure M is expected to result in at least one and likely more than one ballot measure per year.

As outlined above and as further detailed in KMA's impartial analysis, Measure M would create barriers to the City achieving its housing goals, increase developer risks and costs, create significant additional cost to taxpayers, and require an infeasible inclusionary housing percentage that will reduce the amount of affordable housing and market rate housing that will be built.

The following two sections provide additional detail regarding recent State legislation that could trigger a vote of the people under Measure M and provide some of the potential impacts the measure would create in regard to the City achieving its recently-adopted Housing Element objectives.

State Legislation Triggers Votes of the People

While Measure M seems to focus on specific changes to the General Plan or Zoning Ordinance being proposed in City-led planning processes or by developers of homes, numerous State law changes would also trigger the need for a vote of the people under the measure. The State has allowed for increased height or FAR beyond the City's General Plan or Zoning Ordinance many times recently. While the City must follow State law from the date the law goes into effect, fully complying with these laws and providing transparency with respect to applicable development allowances would still require a formal amendment (typically to the Zoning Ordinance), thus triggering a vote of the people under the measure. Each vote would be expensive, and the outcome of the vote would not affect what a developer could do, only whether City codes could be updated to reflect State mandates, because the City would have to comply with State law regardless, or face legal jeopardy.

Below is a sample list of recent legislation that would, under the measure, trigger the need for a vote of the people in order to fully comply with State law through changes to the City's Zoning Ordinance or General Plan to match State law requirements. A vote would be triggered because the bills allow for additional FAR or height beyond what is allowed in the Zoning Ordinance or General Plan, and changing the Zoning Ordinance or General Plan to match State law would trigger a vote of the people under the measure.

2019 Legislation

- AB 68, AB 881, and SB 13 are a package of accessory dwelling unit (ADU) bills that removed parking requirements, parking replacement requirements, removed lot coverage requirement, decreased setback requirements, and increased maximum square footage allowances. They allowed for more square feet of housing than would have been allowed previously under the existing ADU development standards in the Zoning Ordinance.
- AB 1763 created an 80% Density Bonus and a 33-foot height increase for 100% affordable housing. This was an increase beyond the 35% Density Bonus for all projects prior to the bill and provided for more FAR and height than the Zoning Ordinance allowed at the time.

2020 Legislation

- AB 2345 created a 50% Density Bonus for all projects, an increase beyond the 35% Density Bonus for market-rate projects at the time. This bill provided for more FAR than the Zoning Ordinance allowed at the time.
- AB 3162 expanded Accessory Dwelling Unit (ADU) and Junior ADU (JADU) allowances to increase allowable square footage (FAR) in residential zones beyond existing standards in the Zoning Ordinance.

2021 Legislation

- SB 9 increased density and square footage (FAR) in single-family residential zones by allowing property owners to build two primary homes on one lot (exclusive of ADUs/JADUs) or split the lot one time to allow for primary homes on two separate lots.
- SB 478 increased the minimum FAR for projects in areas that allow between two and ten units. The bill required that lot size minimums and lot coverage requirements cannot physically preclude development at these minimum FARs. This law meant that existing height or density standards could be superseded in certain scenarios.

2022 Legislation

- AB 916 increased height allowances, reduced setbacks, and removed front yard lot coverage and lot size requirements.
- AB 2295 allowed multifamily housing projects to be proposed on school property by local educational agencies. Schools are typically located in Public Facility zoning that did not allow multifamily residential previously and this law could result in increased height to meet the allowed development FAR.
- AB 2011 allowed for qualifying residential development to be located in zones that previously only allowed for commercial or mixed-use development at heights potentially greater than the existing Zoning Ordinance.

2023 Legislation

- AB 1287 created a 100% Density Bonus for projects that meet the initial 50% Density Bonus and then provide another 15% of the units at the Moderate Income affordability level. This bill provides for more FAR and height than the Zoning Ordinance currently allows.
- SB 4 is the “Yes in God’s Backyard” bill that allows for qualifying multifamily projects on land owned by faith institutions. Churches are typically in single-family zoning, so this would allow for additional FAR beyond existing standards.
- SB 684 allows for ministerial approval of up to 10-unit housing projects in multi-family zoning. It provides that subdivided lots under this law must allow at least 20 units to the acre in density despite any standards in place that would otherwise not allow that density. This would increase allowable FAR and/or heights in certain circumstances.

Potential Impact on the City's Housing Element

The 6th Cycle Housing Element Update was just found, in December 2023, to be in substantial compliance by the State of California, capping off 18 months of work with the community, stakeholders, housing advocates, the Planning Commission, the Council Subcommittee, and the City Council to create policies and actions that help the City achieve its housing goals and meet the diverse housing needs of the community, including but not limited to housing and housing support services for individuals and households at all income levels. The Housing Element policies and action items received substantial support during this process. However, at least thirteen of these action items could or would require a vote of the people under Measure M and, if not approved, could jeopardize the State's certification of the City's Housing Element. This would result in the "builder's remedy" taking effect in Santa Cruz (so housing developers meeting certain standards would not have to follow any local land use regulations), would eliminate the City's ability to apply for certain grant funds, and would remove the City's Pro-Housing Designation, which provides the City a competitive advantage in securing grant funds. The sections below contain additional information related to this.

A selection of action items from the Housing Element that could or would require a vote of the people under Measure M are detailed below. The Housing Element objectives are shown in italics, with brief analysis following the objective that describes the impacts from Measure M on the City's ability to achieve those objectives. "HCD" refers to the State Department of Housing and Community Development.

1.2a. Adopt a program level EIR and approve the Downtown Plan Expansion Project to facilitate housing development in the expansion area.

The Downtown Plan Expansion project's current draft calls for a maximum height of 85 feet for a limited number of specified sites in the expansion area. This is consistent with the maximum height in the current Downtown Plan. That would constitute a height increase over what is currently in the Zoning Ordinance, thus triggering a vote of the people under Measure M.

The Downtown Plan Expansion also proposes to increase the FAR for certain sites in the expansion area. Increasing the FAR would require changes to the General Plan. FAR is not proposed to be increased above what is already allowed in the current Downtown Plan, but any increase in FAR would require a vote of the people under Measure M.

Requiring a vote of the people to approve the Downtown Plan Expansion Project could also delay, or put into jeopardy, the development of the Santa Cruz Warriors' new arena, because the new arena is depending on residential development as a key funding source. Continued development uncertainty or a reduction in the amount of housing allowed in the expansion area would be costly both for funding the arena and for providing new homes.

1.2d. Adopt rezonings in the Ocean Street Area Plan so that they align with the General Plan development standards.

Rezoning is required to align the Zoning Ordinance development standards with the General Plan development standards to be consistent with State law. This work is to be completed by December 2024, but would be delayed should the rezoning require a vote of the people under Measure M. Should this rezoning not be supported by a vote of the people, the City would further not meet this Housing Element Objective.

While not specifically related to the Housing Element objective noted here, the Council has also provided direction to change the General Plan Land Use Designation of two parcels at the northwest corner of Leonard Street and May Avenue. This would reduce the planned residential capacity of those parcels. Due to the State's "no net loss" of residential capacity, a reduction in residential capacity can only be accomplished while simultaneously increasing the residential capacity of other sites by an equivalent or greater amount. Thus, to accomplish the Council's direction of reducing the residential density/intensity on the May Avenue and Leonard Street properties, Measure M would likely require a vote of the people due to the accompanying required increase in residential capacity elsewhere in the City. The same required voter approval under Measure M would be expected if residential capacity reduction were contemplated anywhere in the City.

1.2e. Support a balance of jobs and housing land uses by only considering residential use in industrial land if it is ancillary to industrial land's full employment capacity being achieved in an economically viable manner and if it does not negatively impact existing or future industrial uses in the area, except in the vicinity of Coral Street on properties where homeless services or affordable housing are identified in the properties' respective General Plan Land Use Designations as an allowable use. Adopt a Coral Street Overlay that builds off existing services and resources to provide homeless services and related residential use standards for that specific, immediate area.

Requiring a vote of the people in order to rezone properties for affordable housing, supportive housing, and homeless services such as a navigation center (homeless shelter with wraparound services, like housing navigation, health services, job training, etc.) would likely delay these much-needed homes and services, possibly resulting in missing the target adoption date of June 2025 set in the Housing Element. Should this rezoning not be supported by a vote of the people under Measure M, the City would further not meet this Housing Element Objective.

1.3e. Adopt code changes that utilize SB 10 allowances to increase residential density in transit rich areas, including evaluation of how deed-restricted affordable housing can be added.

Code changes to allow for increased density in high quality transit areas are set to be completed by March 2026 per the Housing Element. Achieving this action would require increased FARs or heights and would therefore trigger a vote of the people under Measure M.

1.3g. Adopt zoning changes by January 2027 to align development standards and use allowances with the maximum intensity already allowed under state law, following a comprehensive review. Zoning changes will include heights and lot coverages among other development standards. State law requires that properties be allowed to achieve their maximum intensity using either General Plan or Zoning Ordinance standards. The City follows this law currently by waiving standards that preclude maximum densities; however, this creates uncertainty for developers and community members, and code amendments would remedy that uncertainty.

This would require rezonings or changes to Zoning Ordinance development standards to match certain standards allowed in the General Plan, including increases in allowable FARs or heights. Should the changes not be supported through a vote of the people required under the measure, the City would not meet this Housing Element Objective.

1.3i. As part of the HCD Annual Progress Report, the City will monitor the progress of pending projects in the entitlement process, and if projects are not sufficiently progressing toward building permits or if the City is not meeting the pro-rated share of the RHNA at all income levels, including ADU production and affordability, as of midway through the Housing Element Cycle, the City will evaluate its sites inventory and capacity to maintain adequate sites throughout the planning period and, if necessary, identify strategies to streamline and/or assist projects through entitlement, adopt amendments to the ADU development regulations, or implement other strategies, such as general plan and zoning changes to allow for greater residential densities.

Not only would Measure M reduce housing production to the extent that meeting RHNA housing production targets at all income levels would be very unlikely (due to the chilling effects of both the required votes for regulatory changes needed to facilitate projects and due to the high inclusionary requirement making projects infeasible), Measure M would also limit the City's ability to enact policies that could help increase affordable and market rate housing production, as a costly and time consuming vote of the people would be required for modifications to the inclusionary requirements or increases to FARs or heights.

1.4a. Create and/or revise development standards for co-housing, housing cooperatives, live/work and other alternative housing types.

This work could potentially increase the maximum FARs or heights allowed in certain circumstances, and achieving the action would then require a vote of the people under Measure M.

1.5a. Maintain an inventory of ADU applications, location, affordability, etc. to ensure adequate ADU development is occurring to meet the 6th cycle RHNA. Annually review ADU development progress as part of the HCD Annual Progress Report and if necessary, adopt amendments to the ADU development regulations within 18 months of the annual review to further facilitate ADU production.

Should support for additional ADU development be needed, adopting amendments to development standards like height, setbacks, or lot coverage

would be a likely focus, and since those changes would affect allowable heights or FARs, a vote of people would be needed under Measure M.

2.1a. Maintain and implement the City's Inclusionary Ordinance. Review the Inclusionary Ordinance to determine if amendments are needed to ensure that the inclusionary requirements provide the maximum number of affordable units or deeper levels of affordability without being a barrier to housing development, while considering implications for how developers will use density bonus and how the City's Inclusionary Ordinance interfaces with density bonus proposals. Analysis will evaluate affordability levels to incentivize deeper levels of affordable housing, such as extremely low income units, or more moderate income units depending on needs.

One of the greatest concerns with the measure is that increasing the inclusionary requirement could create a barrier to housing, and that is the exact finding in the attached report from KMA. Because the increased inclusionary requirement is not financially feasible as evidenced in the proforma analyses in the KMA report, Measure M would result in less production of market rate *and* less production of affordable housing than under the current inclusionary requirement. Additionally, the City intends to study different levels of affordability as well. Further study may result in ways to retool the Inclusionary Ordinance to be more flexible and allow for different affordability levels like Moderate Income “workforce” housing and Very Low-Income housing to count towards the inclusionary requirement.

2.1b. Develop a program and/or incentives that increase rental and homeownership opportunities for moderate income / workforce housing units.

If alternative approaches of inclusionary requirements were contemplated, as is called for in Objectives 2.1a and 2.1b, such as a lower percentage of units at deeper levels of affordability (such as households making 50% of Area Median Income) or even an inclusionary requirement that is higher than 25% but which caters to Moderate Income households (making up to 120% of Area Median Income), such changes could trigger a vote of the people, since they deviate from the direction that is given in the measure. Not only would the measure result in fewer affordable units and fewer market rate units, it would make it harder (by potentially requiring a costly and time consuming vote of the people) for the City to adjust the inclusionary percentage to meet diverse needs or to reflect market conditions that fluctuate over time.

3.7b. Support and facilitate the efforts of the Santa Cruz City School District to provide workforce housing for its employees and update local codes to match or exceed allowances found in state law. Authorize development of 50 workforce housing units throughout the planning period.

Building off of recent State law changes (2022's AB 2295 noted above), the City could further support workforce housing for school teachers and staff by exceeding the development allowances governed by State law. In certain circumstances, AB 2295 could allow for greater height than the currently allowed

in the Zoning Ordinance so formally adopting this law into the Zoning Ordinance would trigger a vote of the people under Measure M.

If the City chooses to exceed State law to support teacher housing, that scenario would require height and/or FAR increases beyond the existing standards in the Zoning Ordinance and trigger a vote of the people under Measure M.

6.2e. Expand the use of Flexible Density Units into more zoning districts in conjunction with an SB 10 overlay district to provide opportunities for more small units in the City, particularly in higher resource areas.

This action would amend the Zoning Ordinance and, for certain locations, would likely increase either allowable heights or FARs above those that currently exist, so achieving this action would require a vote of the people under Measure M.

6.2f. Develop a local ordinance to implement SB 9 consistent with State law.

As noted under the 2021 Legislation section above, formally adopting SB 9 Zoning Ordinance Amendments to comply State law would trigger a vote of the people under Measure M due to increased FAR allowances on some properties.

In October 2023, HCD's Housing Accountability Unit published a 44-page report detailing San Francisco's lack of housing production and inability to achieve its Housing Element objectives. While Santa Cruz has not had the same level of housing production issues as San Francisco, the report speaks to the seriousness of needing to follow the Housing Element. The full report is available at <https://www.hcd.ca.gov/sites/default/files/docs/policy-and-research/plan-report/sf-housing-policy-and-practice-review.pdf>, and below are direct quotes from the report:

A housing element is not a paper exercise – it is an enforceable commitment to the state that a city or county will take specific actions on specific timeframes over an eight-year period. Once HCD finds an adopted housing element compliant with Housing Element Law, the jurisdiction must work towards implementing the housing element.

If HCD finds that a jurisdiction failed to implement a program included in the housing element, HCD may, after informing the local jurisdiction and providing a reasonable time to respond, revoke its finding of compliance with Housing Element Law until it determines that the jurisdiction has come into compliance.

The City's failure to implement the Required Actions will result in HCD initiating the process to revoke housing element compliance. Various consequences may apply if the City does not have a housing element in compliance with Housing Element Law, including ineligibility or delay in receiving certain state funds, referral to the California Office of the Attorney General, court-imposed financial penalties, the loss of local land use authority to a court-appointed agent, and the application of the "builder's remedy."

As noted with the City's recent Housing Element certification, the "builder's remedy" allows for residential or mixed-use projects meeting certain affordability thresholds to ignore local land use

law and construct those residential or mixed-use projects as whatever standards they like, with no regard to local heights, setbacks, densities, or other development standards.

This report speaks to the State's increasing reach in enforcing housing law, and the City should do everything it can to follow the adopted policies and actions in the Housing Element. It is unlikely Santa Cruz would face the same level of ire from HCD as San Francisco based on the City's recent, positive track record on housing. However, if the City is unable to achieve a number of the objectives identified in the Housing Element, especially if that were coupled with the City not meeting its RHNA targets for housing production, that would capture the attention of HCD, and HCD does have the ability to decertify the City's Housing Element for not carrying out the objectives called for in the plan. In fact, in its December 21, 2023 letter to the City, HCD writes:

Government Code section 65585, subdivision (i) grants HCD authority to review any action or failure to act by a local government that it determines is inconsistent with an adopted housing element or housing element law. This includes failure to implement program actions included in the housing element. HCD may revoke housing element compliance if the local government's actions do not comply with State law.

While cities like San Francisco receive much of HCD's attention for their challenging approach to housing, HCD's recent letter to the City reiterates that Santa Cruz must continue to follow through on its commitments. As detailed above, Measure M would impede the City's ability to achieve many of the Housing Element objectives.

Additional Potential Implications of the Measure

Because Measure M would establish inclusionary standards that would slow the production of housing at all income levels, including for affordable housing, the City would be unlikely to achieve the housing production targets set forth in its RHNA. This would have several consequences.

First, more development would qualify for streamlining under Senate Bill (SB) 35, which requires ministerial approval and no California Environmental Quality Act (CEQA) review for qualifying projects, which is a way the State seeks to incentivize development in jurisdictions where housing production is lagging. However, the benefits of the SB 35 streamlining incentive would be unlikely to overcome the cost burden associated with the City's high inclusionary requirement established by Measure M, so housing production would still lag.

Second, if the City is not on track to meet its RHNA housing production targets at all income levels, pursuant to Objective 1.3i in the newly adopted Housing Element, "the City will evaluate its sites inventory and capacity to maintain adequate sites throughout the planning period and, if necessary, identify strategies to streamline and/or assist projects through entitlement, adopt amendments to the ADU development regulations, or implement other strategies, such as general plan and zoning changes to allow for greater residential densities." As noted above, Measure M would simultaneously reduce the production of affordable and market rate housing and make it more challenging to enact policies that would stimulate production of affordable and market rate housing.

A lack of housing production would certainly catch the attention of HCD. If the City were also unable to achieve many of the Housing Element objectives due to the costs, time, and voting outcomes of elections required under Measure M, then HCD could decertify the City's Housing

Element. Decertification of the HE would have a range of implications. First, “builder’s remedy,” as detailed above, would take effect in Santa Cruz. Second, the City would lose eligibility for State grants and other State funding sources (a primary source of affordable housing funding leveraged currently by the City) and would result in the loss of the City’s Pro-Housing Designation, which provides a competitive advantage to securing State grants.

Health in all Policies (HiAP)

HiAP is a collaborative approach to improving the health of all people by incorporating health considerations into decision-making across sectors and policy areas. HiAP is based on 3 pillars: equity, public health, and sustainability. The goal of HiAP is to ensure that all decision-makers are informed about the health, equity, and sustainability impacts of various policy options during the policy development process. Measure M’s creates barriers to the production of affordable and market rate homes, impacts the City’s ability to comply with State housing requirements, impacts the City’s ability to meet its Housing Element objectives, and results in significant negative fiscal impacts on the City, thereby frustrating all three HiAP pillars of equity, public health, and sustainability, so Measure M is inconsistent with HiAP.

FISCAL IMPACT: As indicated in the attached analysis and that contained in this report, Measure M itself would have long-term negative fiscal impacts to the City. Based on historical and recent trends, including complying with State law, it is anticipated, on average, the measure would result in at least one election/vote of the people per year, and that does not account for any additional, proactive work that the City is doing that would trigger additional votes of the people, including the objectives committed to in the Housing Element. Thus, the estimate that the measure would result in at least one vote of the people per year is conservative, and it would likely result in a higher number of annual votes required. The current cost of an election is estimated to be in the range of \$115,000 to \$185,000 based on figures from the Santa Cruz County Elections Department. This amount may fluctuate, based on the number of registered voters at the time of the election, the number of items the City places on the ballot, and if the election is a special one called solely by the City. The direct fiscal impact to the City would, of course, accumulate over time with each needed election.

The cost of reviewing the measure and preparing this impact report was \$42,000 in consultant fees, plus many hours of staff time that are not included in the \$42,000 in direct costs.

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ATTACHMENTS:

1. KEYSER MARSTON REPORT ON EFFECTS OF MEASURE M
3. OCTOBER 24, 2023 COUNCIL AGENDA REPORT
4. MINUTES FROM OCTOBER 24, 2023 COUNCIL MEETING



KEYSER MARSTON ASSOCIATES

REPORT TO CITY COUNCIL

ON A BALLOT INITIATIVE TITLED
MEASURE M

REQUIRING PRIOR VOTER APPROVAL FOR ANY
AMENDMENT TO GENERAL PLAN OR ZONING
REGULATIONS TO INCREASE HEIGHT LIMIT OR FLOOR
AREA RATIOS; AND INCREASING INCLUSIONARY HOUSING
REQUIREMENTS FROM 20% TO AT LEAST 25% FOR
DEVELOPMENTS WITH 30 OR MORE HOUSING UNITS

PREPARED FOR:
CITY OF SANTA CRUZ

PREPARED BY:
KEYSER MARSTON ASSOCIATES, INC.

JANUARY 18, 2024

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ATTACHMENTS

Attachment 1: Resolution No. NS-30,240

Attachment 2: Affordable Housing Cost Calculation Methodologies

- Appendix A: Affordable Rent Calculation Methodology
- Appendix B: Affordable Sales Price Calculation Methodology

Attachment 3: Apartment Development

- Appendix A: Rent Survey: 4+ Star Properties
- Appendix B: Affordable Rent Calculations
- Appendix C: Pro Forma Analyses: High Density – Traditional Apartment Prototype
- Appendix D: Pro Forma Analyses: Medium Density – Traditional Apartment Prototype
- Appendix E: Pro Forma Analyses: SRO Apartment Prototype

Attachment 4: Ownership Housing Development

- Appendix A: Home Sales Survey
- Appendix B: Affordable Sales Price Calculations
- Appendix C: Pro Forma Analyses: High Density Condominium Prototype
- Appendix D: Pro Forma Analyses: Low Density Condominium Prototype
- Appendix E: Pro Forma Analyses: Townhome Prototype

INTRODUCTION

I. REQUEST FOR AN IMPACT REPORT RELATED TO MEASURE M

At a meeting held on October 24, 2023, the Santa Cruz City Council (City Council) directed City of Santa Cruz (City) staff to prepare an impact report on an initiative that has been placed on the March 5, 2024 primary election ballot. For reference purposes, the initiative has been given the following title:

Measure M
Requiring Prior Voter Approval for any Amendment to General Plan or Zoning Regulations to Increase Height Limits of Floor Area Ratio ; and Increasing Inclusionary Housing Requirements from 20% to at least 25% for Developments with 30 or more Housing Units

Throughout this report the initiative will be referred to as Measure M.

II. REPORT ORGANIZATION

Keyser Marston Associates, Inc. (KMA) was engaged by the City to prepare the impact report that was requested by the City Council. The following report is divided into the following two components:

A. Restrictions on General Plan & Zoning Ordinance Amendments

The following issues that could potentially be impacted by the Measure M limitations are evaluated on a qualitative basis:

1. City actions that would trigger the Measure M requirements.
2. Issues related to projects applying to use the California Government Code Section 65915 et seq. (Section 65915) density bonus statute.
3. The increased risk borne by developers considering projects that would be subject to a vote of the people.

4. The impact on achieving compliance with existing and future Regional Housing Needs Allocation (RHNA) targets.
5. The potential fiscal impact to the City.

B. Inclusionary Housing Requirements

The City's original Inclusionary Housing Ordinance was adopted following the passage of Measure O in 1980, which imposed a 15% affordable housing requirement on new residential development within Santa Cruz. The Inclusionary Housing Ordinance has been amended multiple times over time, with the most recent being Ordinance 2019-25, which went into effect in February 2020, and which imposed a 20% affordable housing requirement on new residential development.¹ Measure M proposes to increase the Inclusionary Housing requirement to at least 25% for new residential developments that include 30 or more units.

KMA prepared an Inclusionary Housing: Financial Evaluation (Financial Evaluation) to analyze the impacts created by increasing the affordable housing requirement to 25% for new residential developments that include 30 or more units. The analysis is organized as follows:

1. The influences that court cases and legislation have on the Inclusionary Housing requirements that can be imposed by the City are discussed.
2. Financial testing was performed to evaluate the feasibility of increasing the percentage of affordable housing units that are required to be developed in new residential developments in Santa Cruz.

¹ The City's Inclusionary Housing requirements are codified in Chapter 24.16 of the Santa Cruz Municipal Code.

EXECUTIVE SUMMARY

I. RESTRICTIONS ON GENERAL PLAN & ZONING ORDINANCE AMENDMENTS

The City received a Sixth Cycle RHNA target of 3,736 units. In part to assist in fulfilling the current and future obligations, the City commenced work on the Downtown Expansion Plan (DTEP) in 2020, which is anticipated to include amendments to the General Plan and Zoning Ordinance that will increase the allowable building heights and floor area ratios (FARs) for residential development.

A. City Actions that would Trigger the Measure M Requirements

One of the authors' stated purposes for putting Measure M forward is to subject any proposed increases in building heights and/or FARs in downtown development to a vote of the people. While it does that, as written, the Measure M voting requirements impose the following broader constraints:

1. They apply on a citywide basis in all zoning districts.
2. They apply to regulations pertaining to a wide array of developments including accessory dwelling units (ADUs) in certain Coastal Zone locations, single family homes, commercial/industrial buildings, and 100% affordable housing projects.
3. They constrain the City's ability to comply with State law requirements to align development standards and use allowances by 2027. This alignment is called for in the City's Sixth Cycle Housing Element (Housing Element), which has been certified by the California Department of Housing and Community Development (HCD).
4. They potentially impede the City's ability to adhere to the California Government Code Sections 65863 and 66300 "no net loss" requirements.
5. They will trigger a Measure M vote of the people requirement to bring the City's Zoning Ordinance and/or General plan into compliance with new State legislation that results in mandated increases to allowable residential building heights and/or FARs.

B. Section 65915 Density Bonus Issues

The Section 65915 density bonus provides developers with the opportunity to significantly modify development standards without requiring amendments to the General Plan or Zoning Ordinance. For example, the City will be required to approve the increases in building heights and FARs that are commonly requested as the statutorily provided incentives/concessions or development standards waivers. These modifications, in and of themselves, do not constitute changes to the General Plan or Zoning Ordinance. As such, they would not trigger a Measure M vote of the people.

C. Increased Developer Risk

The imposition of a voter approval requirement on a proposed development negatively impacts the desirability of the investment. This impact is related to the combination of the increased uncertainty in the entitlement process, the additional costs incurred during the process, and by the risk that the voters will not approve the General Plan and/or Zoning Ordinance changes needed to allow the project to proceed. This may act to reduce the number of residential projects that are proposed by experienced and well capitalized developers.

D. Measure M Impacts on the City's RHNA Targets and Housing Element

HCD has imposed strict timelines for jurisdictions to adopt General Plan designations and zoning standards that comply with their RHNA targets. If the housing production targets and objectives identified in the Housing Element are not achieved within the timelines specified, the developers of eligible housing projects would be allowed to use the housing development application streamlining provisions set for in California Government Code Section 65913.4.² This removes some local decision-making control, and exempts proposed projects from California Environmental Quality Act review.

Complying with the HCD requirements is made more challenging by Measure M. In addition to the risk that developers will be reluctant to take the risk of voter approval, there is the significant potential that certain sites may not be approved by the voters for additional height and/or FAR. Measure M

² These provisions were created by Senate Bill 35, which went into effect on January 1, 2018.

could also make achieving Housing Element objectives more difficult as it would trigger a vote of the people in order to implement Objectives 1.2a, 1.2d, 1.2e, 1.3e, 6.2f, and others.

The ultimate penalty is that HCD could potentially decertify the City's Housing Element. This would trigger a variety of penalties including limiting the City's ability to enforce General Plan and Zoning Ordinance standards, disqualification for the award of affordable housing assistance funds provided by the State, and monetary penalties that may be devised by the State Legislation in the future.

E. Fiscal Impacts

It is anticipated that if Measure M goes into effect at least one election/vote of the people per year would be required. Based on estimates provided by the Santa Cruz County Elections department, the current cost of an election falls within the range of \$115,000 to \$185,000.

There continues to be significantly more demand for housing than the supply of housing in Santa Cruz. As a result, housing is becoming increasingly unaffordable each year. It can reasonably be assumed that the requirements imposed by Measure M will negatively impact the potential for the development of both market rate and affordable housing. To mitigate this problem the City will likely need to create and fund additional programs that reduce displacement of existing residents and that assist in the development of dedicated affordable housing projects beyond those that the City already supports.

II. INCLUSIONARY HOUSING REQUIREMENTS

The KMA Los Angeles office has assisted 37 jurisdictions in the Inclusionary Housing program adoption and updating processes over the past 25 years. KMA's analyses reflect a real world perspective based on the firm's core experience in real estate development economics, real estate transactions, and developer negotiations services.

The imposition of income and affordability restrictions on units in a market rate residential development creates an impact on the project economics. The fundamental purpose of the Financial Evaluation is to determine whether the Inclusionary Housing requirements included in Measure M comport with the requirements that have been imposed on Inclusionary Housing programs by the

courts and the State Legislature. Based on these requirements, the fundamental standards that must be imposed are:³

1. Inclusionary Housing requirements cannot be confiscatory;
2. Inclusionary Housing requirements cannot deprive a property owner of a fair and reasonable return on investment; and
3. Inclusionary Housing requirements cannot act as a constraint to housing development.

A. Financial Analysis Components

The Financial Evaluation tested three apartment development prototypes and three ownership housing development prototypes. The prototypes were created using the City’s “Active Planning Applications” webpage and the Housing Element. These prototypes can be described as follows:

Market Rate Residential Development Prototypes Inclusionary Housing : Financial Evaluation	
Apartment Prototypes	Ownership Housing Development Prototypes
High Density – Traditional Apartment Base Density: 150 Units Per Acre Density Bonus: 225 Units Per Acre	High Density Condominium Base Density: 125 Units Per Acre Density Bonus: 169 Units Per Acre
Medium Density – Traditional Apartment Base Density: 60 Units Per Acre Density Bonus: 90 Units Per Acre	Low Density Condominium Base Density: 30 Units Per Acre Density Bonus: 45 Units Per Acre
SRO Apartment Base Density: 125 Units Per Acre Density Bonus: 188 Units Per Acre	Townhome Base Density: 15 Units Per Acre Density Bonus: Not Applicable

³ The first two requirements were imposed by the California Supreme Court in *California Building Industry Association v. City of San Jose*. The third requirement is imposed by California Government Code Section 65583 (A).

The Financial Evaluation estimates the “Affordability Gaps” associated with the defined income and affordability restrictions. An Affordability Gap is defined as the difference between the achievable market rate rents or sales prices and the allowable rents or sales prices for each “Inclusionary Unit”. This Financial Evaluation uses pro forma analyses to estimate the Affordability Gaps generated by the existing Inclusionary Housing requirements and the requirements proposed by Measure M.

B. Financial Evaluation Findings

There is very little vacant developable land left in Santa Cruz. As a result, the majority of recent new residential development has been occurring on properties that are developed with existing improvements. The Housing Element makes the fundamental assumption that this will continue to be the case. For this to occur, the property value supported by residential development must be competitive with the other opportunities available to property owners.

Based on the results of the pro forma analyses, KMA reached the following conclusions:

1. Apartment Development:
 - a. Under current conditions, the existing 20% Inclusionary Housing requirement can only be supported if the project can make use of the Section 65915 density bonus on a cost efficient basis.
 - b. A 25% Inclusionary Housing requirement could not be supported by any of the apartment prototypes even it was assumed that the maximum Section 65915 density bonus was applied.
2. Ownership Housing Development:
 - a. Under current conditions ownership housing development cannot support an affordable housing requirement of any kind.
 - b. It is possible that developers of some mapped apartment projects may ultimately sell the units. However, the opportunities for this to occur will be constrained by the

imposition of the current 20% Inclusionary Housing obligation. This constraint will be exacerbated if the Inclusionary Housing requirement is increased to 25%.

As discussed previously, the courts and the State legislature have imposed the following requirements on Inclusionary Housing programs:

1. Inclusionary Housing requirements cannot be confiscatory;
2. Inclusionary Housing requirements cannot deprive a property owner of a fair and reasonable return on investment; and
3. Inclusionary Housing requirements cannot act as a constraint to housing development.

Based on the results of the Financial Evaluation KMA reached the following conclusions:

1. The Measure M requirement to increase the Inclusionary Housing obligation to 25% for projects with 30 or more units does not comport with any of the requirements imposed by the courts and the State Legislature.
2. Given the financial impacts created by the proposed increase in the Inclusionary Housing obligations, residential development will not be competitive with the other disposition or holding opportunities available to property owners.
3. If Measure M passes, significant potential exists for legal challenges from residential developers and/or an HCD constraint to housing investigation. This could possibly result in the decertification of the City's Housing Element.

RESTRICTIONS ON GENERAL PLAN & ZONING ORDINANCE AMENDMENTS

The City received a Sixth Cycle RHNA target of 3,736 units. To assist in fulfilling this and future obligations, the City commenced work on the DTEP in 2020 with one of the fundamental purposes being to increase the potential for residential development to be attracted to the downtown area. To achieve this, the proposed DTEP is anticipated to include amendments to the General Plan and Zoning Ordinance that will increase the allowable building heights and floor area ratios (FARs) for residential development.

One of the authors' stated purposes for putting Measure M forward is to subject any proposed increases in building heights and/or FARs in the downtown to a vote of the people. However, as written, Measure M requirements actually would apply on a citywide basis. In addition, the Measure M requirements would be retroactive to June 1, 2023.

The following sections of this report describe the impacts that could potentially be generated by the Measure M requirements.

I. CITY ACTIONS THAT WOULD TRIGGER MEASURE M REQUIREMENTS

A. Development Types that are Subject to the Measure M Requirements

The term "Development Project" is defined in Municipal Code Chapter 24.22.265 as:

Any project undertaken for the purpose of development. Includes a project involving the issuance of a permit for construction or reconstruction, but not a permit to operate. Does not include ministerial projects proposed to be carried out or approved by the City.

The use of the term development project in Measure M means that any change to the Zoning Ordinance, Zoning Ordinance Map, General Plan, or General Plan Land Use Map, which increases the building height and/or FAR for any project that requires a discretionary permit (other than just a use permit), would trigger a vote of the people. The following development types provide a sample of projects that can potentially require a discretionary permit:

1. Single family homes;
2. ADUs in certain Coastal Zone locations;
3. Multifamily residential projects, including residential projects in which 100% of the units are subject to income and affordability covenants;
4. Mixed-use projects;
5. Commercial projects;
6. Industrial projects;
7. Public building construction projects carried out by the City;
8. Some fences, including fences on single family home properties; and
9. Properties on the City's Historic Survey.

B. Examples of Potential Measure M Triggers

CHANGES TO GENERAL PLAN TEXT, ZONING ORDINANCE TEXT, GENERAL PLAN LAND USE DESIGNATIONS, AND/OR ZONING DESIGNATIONS

Measure M would require voter approval for any modifications to the Zoning Ordinance and/or General Plan when the changes result in increased height and/or FAR allowances for any project that requires a discretionary permit from the Planning Department.⁴ The Measure M voter approval requirement applies to residential, commercial, industrial, mixed use, and public spaces development located anywhere within the Santa Cruz city limits.

The Measure M requirements apply to a broad range of changes, including but not limited to the following actions:

⁴ Projects that only require a use permit would not trigger a Measure M vote of the people.

1. Changing the General Plan land use designation (General Plan Land Use Map) in a manner that increases height and/or FAR allowances.
2. Changing the Zoning Designation (Zoning Map) in a manner that increases height and/or FAR allowances.
3. Changing the text of the General Plan or Zoning Ordinance in a manner that increases height and/or FAR allowances. The following actions could impact height and/or FAR, which would in turn trigger a Measure M vote of the people:
 - a. Changes to certain setbacks;
 - b. Changes to certain lot coverage requirements;
 - c. Changes to certain building separation requirements;
 - d. Changes to certain limitations on the number of stories allowed; and/or
 - e. Other standards that effect height or FAR for “development projects”, which includes a broad array of potential projects, as noted above.

DEVELOPMENT STANDARDS ALIGNMENT

State law requires the City to adopt zoning changes by 2027 to align development standards and use allowances with the maximum intensity already allowed by State law. Specifically, properties must be allowed to achieve the maximum intensity permitted under the General Plan or Zoning Ordinance standards. This includes height and lot coverage standards. Pertinent examples are:

1. The zoning standards in place in the Ocean Street Area Plan, which need to be amended to be consistent with the General Plan development standards.
2. It would be useful to adopt Code amendments to provide clarity to the development standards that would be applicable in the following cases:

- a. The minimum lot size requirement for properties subject to R-L zoning.
- b. The property located at 125 Coral Street, which is anticipated to be developed with a five-story physical health, mental health, navigation center with permanent supportive housing and/or an expanded homeless shelter.
- c. The affordable housing project proposed to be developed on the northeast corner of Highways 1 and 9, which could trigger the Measure M requirements depending on the modifications that are ultimately requested.
- d. The prospective development of the properties located on the north side of Mission Street at Center Street.
- e. The DTEP, particularly as it pertains to the development of the four corners of Front Street and Spruce Street to 140 Center Street.

NO NET LOSS REQUIREMENTS

California Government Code Sections 65863 and 66300 impose a “no net loss” standard on jurisdictions that requires any reduction in residential capacity to be concurrently accompanied by an equivalent increase in residential capacity elsewhere. This standard is measured against the unit count projections the City included in the “Housing Element Sites Inventory”. Examples of activities that could invoke a requirement to increase capacity elsewhere in Santa Cruz are:

- 1. Any project that is developed on a listed site and that provides fewer than the identified target number of units.
- 2. City actions that reduce the residential capacity on a listed site by reducing height, FAR, dwelling units per acre, and/or increasing setback requirements.

This explicit requirement to increase the allowable unit count on other sites would likely necessitate increasing the allowable FAR and likely height on those sites. This would trigger a Measure M vote of the people.

STATE LEGISLATIVE ACTIONS

State legislation can result in mandated increases to allowable residential building heights and/or FARs. As written, this will trigger a Measure M vote of the people to make the City's Zoning Ordinance and/or General Plan consistent with State standards. This is the case despite the fact that the City has no authority to override the State requirements. Some examples are:

1. Authority to construct residential projects on commercially zoned sites;
2. Authority to construct residential units on school and religious properties;
3. Prohibition on coupling minimum lot sizes and lot coverage ratios with minimum FAR standards, which act to preclude development of residential projects of up to 10 units;
4. Increasing the maximum height limits for ADU's; and
5. Lot splits allowed in single family zones.

II. SECTION 65915 DENSITY BONUS ISSUES

Height and FAR increases are two of the most commonly requested incentives/concessions and development standards waivers by applicants using the Section 65915 density bonus. Key requirements imposed by Section 65915 are:

1. The City must grant the applicant's request for an incentive/concession unless the City makes a written finding, based on substantial evidence, that the requested FAR incentive/concession does not comport with the very limited criteria defined in Section 65915 (d) (1).
2. Section 65915 (e) states that the City cannot apply any development standard that physically precludes the construction of a project at the density allowed by Section 65915 along with the permitted incentives/concessions:
 - a. Development standards waivers do not reduce the number of incentives or concessions to which the project is entitled.

- b. There is no stated limit to the number of development standards waivers that can be requested.
3. Section 65915 (d) (3) provides the Applicant with the right to pursue legal action if the City denies a requested incentive/concession or waiver. If the court finds against the City, the City would be required to pay the applicant's reasonable attorney's fees and the costs associated with the lawsuit.

As discussed in detail in the Inclusionary Housing Requirements section of this report, it is likely that the vast majority of residential developers will make use of the Section 65915 density bonus benefits. This provides developers with the opportunity to significantly modify development standards without amendment to the General Plan or Zoning Ordinance. As such, the use of the Section 65915 density bonus should not trigger a Measure M vote of the people even though it will likely result in increased building heights and FARs in many cases.

III. INCREASED DEVELOPER RISK

The development process is fraught with several levels of risk, but in general developers seek out development opportunities in which the entitlement process is well defined, and uncertainty is minimized. The imposition of a voter-approval requirement creates the following key impacts:

1. It increases the inherent risk that a development will not be approved;
2. It requires developers to make a substantial investment of capital prior to placing the proposed development in front of the voters; and
3. It prolongs the development process, which increases the carrying costs incurred by the proposed development.

A review of the available scholarly literature provides consistent evidence that imposing voter-approval requirements on proposed development creates a negative impact on development opportunities. This impact is caused by the combination of the increased uncertainty involved in the development

approval process, the additional costs incurred during the process, and the risk that the voters will not approve projects that are put forward for a vote. It is reasonable to conclude that the voter approval requirements imposed by Measure M will discourage some developers from pursuing projects that require height and/or FAR increases.

IV. MEASURE M IMPACT ON THE CITY'S RHNA TARGETS AND HOUSING ELEMENT

HCD has imposed strict timelines for jurisdictions to adopt General Plan designations and zoning standards that comply with their RHNA targets. Requiring a vote of the people to ratify the necessary modifications will potentially create the following impacts:

1. The voter approval requirement may discourage both the developers of market rate housing and affordable housing from pursuing residential development in Santa Cruz.
2. The entitlement period for impacted residential developments will be extended by the election timing.
3. Proposed projects that require height and/or FAR increases may be voted down in Measure M elections.

The combination of these factors could decrease the number of residential units that are actually produced to below the targets included in the Housing Element. This would create the following impacts:

1. Developers of eligible projects would be allowed to use the housing development application streamlining provisions provided by California Government Code Section 65913.4. However, the use of this provision would likely be limited due to the various costs associated with Measure M compliance, most notably the increased Inclusionary Housing requirement.
2. For the current Housing Element, limited housing production would result in the requirement for the City to implement additional measures to increase housing production, as is called for in Objective 1.3i of the Housing Element:

- a. These changes would likely include actions that require Measure M voter approval; and
 - b. If housing production numbers are lagging, and the City does not adopt policy changes to further promote housing production, HCD could potentially de-certify the City's Housing Element.
3. For future Housing Elements, limited housing production and the smaller development project pipeline will reduce the number of sites that HCD finds acceptable for the future Housing Elements Sites Inventory:
- a. This will make it more likely that General Plan and/or Zoning Code amendments will be necessary to establish an sites inventory with sufficient residential capacity.
 - b. These amendments would likely trigger the Measure M voter approval requirement, which could potentially create the following impacts:
 - i. The process could delay the process beyond the State mandated deadlines; and/or
 - ii. The voters could reject the proposed amendments.
 - c. As a result, HCD could potentially decertify the City's Housing Element.

Lack of a certified Housing Element would result in the following impacts:

- 1. California Government Code Section 655589.5, also known as Builder's Remedy, could be invoked. This allows developers to build residential projects that do not comply with either the General Plan or the Zoning Ordinance.
- 2. Leveraged affordable housing projects being pursued by the City and/or developers would be ineligible to receive assistance funding offered by the State.
- 3. The City's Pro-Housing Designation would be revoked. This designation provides the City with a competitive advantage in securing grants offered by the State.

4. The State Legislature Penalties may continue their recent practice of enacting monetary penalties for noncompliance with Housing Element requirements.

V. FISCAL IMPACTS

A. Election Costs

Based on historical and recent trends, including complying with State law, it is anticipated that on average the passage of Measure M would result in at least one election/vote of the people per year. Based on estimates provided by the Santa Cruz County Elections department, the current cost of an election falls within the range of \$115,000 to \$185,000. This amount will fluctuate based on the following factors:

1. The number of registered voters at the time of the election;
2. The number of items the City places on the ballot; and
3. Whether the item is placed on a regularly scheduled election or if a special election is called by the City.

B. Housing Supply

Due in large part to the existence of significantly more demand for housing than the supply of housing in Santa Cruz, housing costs continue to outpace inflation. Passage of Measure M will clearly create a constraint to the future development of both market rate and affordable housing. The resulting reduction in housing production will necessitate the creation and funding of additional programs to reduce displacement of existing residents and to assist in the development of dedicated affordable housing projects.

Since the State's elimination of redevelopment agencies in 2012 no new ongoing source of dedicated affordable housing funding has been identified or made available to local governments for affordable housing production. The need to develop and fund new affordable housing programs will place a further strain on the City's General Fund unless or until a new funding source is created.

The potential for a community led initiative to create a new funding source is being contemplated locally. However, currently no such funding stream exists at the local, regional or state level to offset the increased constraint to the future development of affordable housing that would be created under Measure M.

INCLUSIONARY HOUSING REQUIREMENTS

I. INCLUSIONARY HOUSING PROGRAM STRUCTURING ISSUES

In the process of evaluating the increase in the Inclusionary Housing obligations proposed by Measure M it is important to understand that the courts and the State Legislature have placed the following key limitations on the requirements that can be imposed Inclusionary Housing Programs:

A. San Jose Case

In 2015, the California Supreme Court ruled in the *California Building Industry Association v. City of San Jose*, 61 Cal 4th 435 (*San Jose*) that Inclusionary Housing Ordinances should be viewed as use restrictions that are a valid exercise of a jurisdiction's zoning powers. The limitations imposed by the Court can be summarized as follows:

1. The requirements cannot be "Confiscatory"; and
2. The requirements cannot deprive a property owner of a fair and reasonable return on their investment.

Since the Court did not provide criteria under which jurisdictions can evaluate these limitations, each jurisdiction is left to create an evaluation methodology. The objective is to balance the interests of property owners, developers and the jurisdiction's need for affordable housing.

B. Assembly Bill 1505

Assembly Bill (AB) 1505 amended Section 65850 of the California Government Code and added Section 65850.01. This legislation provides jurisdictions with the ability to adopt programs that impose Inclusionary Housing requirements on apartment developments.

Section 65850.01 does not place a cap on the percentage of units that can be subject to income and affordability restrictions. However, Section 65850.01 (a) gives HCD the authority to review the restrictions imposed by an Inclusionary Housing Program on apartment developments if it requires that more than 15% of the units to be restricted to households earning less than 80% of the area median income (AMI), and if one of the following conditions applies:

1. The jurisdiction has failed to meet at least 75% of its share of its above moderate income Regional Housing Needs Allocation over at least a five year period, based on the jurisdiction's Annual Housing Element Report; or
2. HCD finds that the jurisdiction has not submitted their Housing Element report for at least two consecutive years.

At this time, the City has fulfilled the requirements imposed by both of the standards identified above. As such, HCD does not have authority under Section 65850.01 (a) to review the Inclusionary Housing requirements Measure M proposes to impose. However, in a technical guidance memorandum dated October 21, 2019, HCD reaffirmed its authority to review Inclusionary Housing ordinances as part of its review of a jurisdiction's Housing Element.

As discussed previously, the current 6th Cycle RHNA targets for housing creation will pose a significantly greater challenge for the City to achieve. It is possible that the City may find itself subject to these provisions within a five-year timeframe if substantial progress on the current RHNA targets is not achieved.

C. California Government Code Section 65583 (A)

California Government Code Section 65583 (a) requires the City to analyze potential and actual constraints being placed on the development of housing. HCD has the discretion to require the City to demonstrate that the Inclusionary Housing requirements do not create a constraint to housing development.

The imposition of the 25% Inclusionary Housing requirement proposed by Measure M could potentially instigate an HCD review. If such an evaluation concludes that a 25% Inclusionary Housing requirement creates a constraint to housing development it is possible that the City’s Housing Element could be de-certified. The implications of not having a certified Housing Element are described in the previous chapter of this report.

II. FINANCIAL EVALUATION METHODOLOGY

A. Financial Evaluation Structure

The analysis structure applied by KMA can be described as follows:

1. KMA prepared financial analyses to assist in identifying the impacts associated with imposing income and affordability requirements on new market rate residential developments.
2. In general terms, the financial impact associated with fulfilling Inclusionary Housing requirements within market rate projects is equal to the Affordability Gap between the achievable market rate rents or sales prices and the allowable rents or sales prices for the Inclusionary Units.
3. The KMA financial analyses test the impacts associated with the existing and proposed Inclusionary Housing production requirements.

The KMA financial analyses components are described in the following sections of this report.

B. Residential Development Prototypes

To assist in creating development prototypes for use in the evaluation, KMA reviewed the City’s “Active Planning Applications” webpage and the Housing Element. It is important to understand that the prototypes used in the Financial Evaluation do not represent actual projects. Instead, the prototypes represent composites of projects that have recently been developed or proposed for development and the results of KMA market surveys.

C. Pro Forma Analyses

Apartment Development Prototypes

KMA prepared pro forma analyses for the following apartment development prototypes:

1. A high density traditional apartment development;
2. A medium density traditional apartment development; and
3. A single room occupancy (SRO) development.

The following development scope and affordability standards were tested for the apartment development alternatives:

Development Scope and Affordability Standards Apartment Development Prototypes			
	Inclusionary Housing Low Income 80% of AMI	Section 65915 Very Low Income 50% of AMI	Total Affordable Housing Requirement
Base Zoning Scenario	20%	NA	20%
Section 65915: 50% Density Bonus Scenarios			
Option 1	5%	15%	20%
Option 2	10%	15%	25%

Ownership Housing Development Prototypes

KMA prepared pro forma analyses for the following ownership housing development prototypes:

1. A high density condominium development;
2. A low density condominium development; and
3. A townhome development.

The following development scope and affordability standards were tested for the ownership housing development alternatives:

Development Scope and Affordability Standards High Density Condominium Alternative Ownership Housing Development Prototypes			
	Base Zoning	35% Density Bonus	
		Option 1	Option 2
Inclusionary Units: Moderate Income Units @ 110% of AMI	20%	9%	14%
Section 65915 Very Low Income Units @ 50% of AMI	NA	11%	11%
Total Affordable Housing Requirement	20%	20%	25%

Development Scope and Affordability Standards Low Density Condominium Alternative Ownership Housing Development Prototypes			
	Base Zoning	50% Density Bonus	
		Option 1	Option 2
Inclusionary Units: Moderate Income Units @ 110% of AMI	20%	5%	10%
Section 65915 Very Low Income Units @ 50% of AMI	NA	15%	15%
Total Affordable Housing Requirement	20%	20%	25%

Development Scope and Affordability Standards Townhome Alternative No Density Bonus Scenarios Ownership Housing Development Prototypes	
Existing Inclusionary Housing Requirements	20% Moderate @ 110% of AMI
Measure M Inclusionary Housing Requirements	25% Moderate @ 110% of AMI

Caveats

The following caveats apply to the pro forma analyses:

1. A fundamental premise of the pro forma analyses is that Measure M is not proposing to modify the affordable housing cost calculation methodologies that are imposed by the existing Inclusionary Housing program.
2. In each apartment and ownership housing prototype analysis, the affordable housing requirements are measured against the number of units allowed by the base zoning standards imposed on the development site.
3. Based on the Affordable Rent and Affordable Sales Price calculation methodologies imposed by Section 65915 (c) (1) (B), and the sliding scale density bonuses provided by Section 65915 (f), it is mathematically most advantageous from a financial standpoint to fulfill the Section 65915 affordability requirements with very low income units.
4. The City's Inclusionary Housing program, as detailed in Municipal Code Chapter 24.16, requires ownership housing developments with five or more units to allocate 20% of the units to low and moderate income households. KMA prepared this Financial Evaluation based on the assumption that the entire obligation can be fulfilled with moderate income units.
5. The Townhome Prototype analysis does not include any Section 65915 density bonus alternatives. This is because townhome projects do not typically require the density bonus, incentives/concessions and development standards waivers to maximize the development's value.

D. Financial Evaluation Tests

It has been KMA's experience that the following series of events occurs following the increase in the requirements imposed by an Inclusionary Housing program:

1. Profits are reduced for developers that have already purchased land.

2. Developers that have not purchased land attempt to bargain for a lower land price.
3. Some property owners are reluctant to accept the fact that their land value has decreased, and they defer selling the property until prices increase.

Each of these three factors is relevant in the assessment of the impact created by an increase in Inclusionary Housing obligations:

1. City staff have received questions from developers regarding a number of properties, which may indicate property acquisitions since June 1, 2023. If Measure M passes, it is likely that developers that acquired property after June 1, 2023, but had not yet entered the formal approval process, will challenge the legality of imposing the requirements retroactively.
2. Developers that had complete applications or formal SB 330 preliminary applications prior to June 1, 2023 would not be subject to the Measure M requirements, assuming the project proceeds and retains its grandfathering under the prior regulations.

In recognition of this assumption, KMA has placed the most weight on the following impacts:

1. The reduction in property acquisition cost that would need to be achieved to offset the impact created by the proposed 25% Inclusionary Housing requirement; and
2. The increase in market rate rents and sales prices that would be needed to offset the proposed requirements.

The preceding tests are the evaluation methodology used to balance the impacts that increasing the Inclusionary Housing requirements has on developers and property owners. Specifically, the factors to be considered are:

1. The need for residential development to support land values that are competitive with other potential uses, and that exceed the value the property owner is currently receiving from the existing use of the property; and

2. To gain an understanding of the near-term increases in achievable market rate rents and sales prices that would need to be achieved to offset the impacts created by the increased Inclusionary Housing requirement.

It is important to understand that every proposed residential development embodies unique characteristics. As such, the benchmarks presented in the following table were used collaboratively to identify the Inclusionary Housing requirements that can be supported:

Benchmark Evaluation Standards Inclusionary Housing Evaluation	
Reduction in property acquisition cost needed to offset the impact created by the Inclusionary Housing requirements.	30%
The increase in market rate rents and sales prices that would be needed to offset the proposed requirements.	4%

Ideally, both benchmark standards would be met. However, to give the 25% Inclusionary Housing requirement the best chance of being deemed to be supportable, KMA only required one of the benchmarks to be achieved in each alternative being evaluated.

E. Financial Analysis Organization

The following sections of the Financial Evaluation describe the assumptions, analysis and findings related to apartment and ownership housing developments. The analyses are supported by the following Attachments:

Financial Analysis Organization	
Attachment 2:	Affordable Housing Cost Calculation Methodology
Attachment 3:	Apartment Development
Attachment 4:	Ownership Housing Development

III. APARTMENT DEVELOPMENT ANALYSIS

KMA created three prototype apartment development scenarios that were used to evaluate the impacts created by variations in site sizes and densities of the project types anticipated to be developed in Santa Cruz. The characteristics of the apartment development prototypes are described in the following table:

Project Descriptions Apartment Development Prototypes					
Alternative	Site Area (Acres)	Base Zoning		Section 65915 Density Bonus	
		Density (Units / Acre)	Total Number of Units	Density (Units / Acre)	Total Number of Units
High Density	1.0	150	150	225	225
Medium Density	0.5	60	30	90	45
SRO	0.75	125	94	188	141

A. Pro Forma Organization and Assumptions

MARKET RATE SCENARIOS

The 100% market rate unit apartment development prototypes provide baselines against which to measure the impacts created by affordable housing requirements. The pro forma analyses for the 100% market rate unit scenarios are organized as follows:

Pro Forma Analysis - 100% Market Rate Scenario Apartment Development Prototypes	
Table 1:	Estimated Development Costs
Table 2:	Estimated Stabilized Net Operating Income
Table 3:	Stabilized Return on Total Investment

The stabilized returns on investment generated by the 100% market rate scenarios are used as the benchmark returns for the purpose of estimating the impacts created by the imposition of Inclusionary Housing obligations. KMA measured the financial impacts created by the imposition of Inclusionary Housing requirements using the tools described previously in this Financial Evaluation.

AFFORDABLE HOUSING SCENARIOS

The pro forma analyses for the affordable housing scenarios are organized as follows:

Pro Forma Analysis – Affordable Housing Alternatives Apartment Development Prototypes	
Table 1:	Estimated Development Costs
Table 2:	Estimated Stabilized Net Operating Income
Table 3:	Financial Impacts: Inclusionary Housing Requirements

The “Affordable Rent” calculation methodology is described in Attachment 2: Appendix A and the Affordable Rent calculations are detailed in Attachment 3: Appendix B. The results are presented in the following table:

Affordable Rents Apartment Development Prototypes		
Number of Bedrooms	Inclusionary Housing	Section 65915
	Low Income 80% of AMI	Very Low Income 50% of AMI
Studio	\$1,974	\$1,005
1	\$2,252	\$1,144
2	\$2,503	\$1,258

B. Alternatives Testing

HIGH DENSITY – TRADITIONAL APARTMENT PROTOTYPE

The analysis of the High Density - Traditional Apartment Prototype is presented in Attachment 3 – Appendix C. The results are summarized in the following table:

High Density - Traditional Apartment Prototype Base Case Density: 150 Units/Acre Apartment Development Prototypes				
	MARKET RATE ALTERNATIVE	20% LOW INCOME INCLUSIONARY ALTERNATIVE	50% §65915 DENSITY BONUS ALTERNATIVE	
			BASE ZONING UNITS: 15% AT VERY LOW INCOME + 5% AT LOW INCOME	BASE ZONING UNITS: 15% AT VERY LOW INCOME + 10% AT LOW INCOME
<u>Project Description</u>				
Site Area (Sf)	43,560	43,560	43,560	43,560
Density (Units/Acre)	150	150	225	225
Unit Mix				
Studio/SRO Units	60	60	90	90
One Bedroom Units	75	75	112	112
Two Bedroom Units	15	15	23	23
Total Units	150	150	225	225
Parking Spaces Per Unit	1.10	1.10	0.50	0.50
<u>Development Costs</u>				
Property Acquisition Costs	\$4,356,000	\$4,356,000	\$4,356,000	\$4,356,000
Construction Costs	94,827,000	94,727,000	133,537,000	133,506,000
Total Development Cost	\$99,183,000	\$99,083,000	\$137,893,000	\$137,862,000
Per Unit	\$661,200	\$660,600	\$612,900	\$612,700
Stabilized Net Operating Income	\$4,760,700	\$4,286,800	\$6,452,100	\$6,322,700
<u>Total Financial Impact</u>				
Required Prop Acq Cost Reduction (\$)		\$9,773,000	\$3,472,000	\$6,137,000
Required Prop Acq Cost Reduction (%)		224%	80%	141%
% Rent Increase to Offset Impact		10.7%	2.3%	4.3%

MEDIUM DENSITY – TRADITIONAL APARTMENT PROTOTYPE

The analysis of the Medium Density - Traditional Apartment Prototype is presented in Attachment 3 – Appendix D. The results are summarized in the following table:

Medium Density - Traditional Apartment Prototype				
Base Case Density: 60 Units/Acre				
Apartment Development Prototypes				
	MARKET RATE ALTERNATIVE	20% LOW INCOME INCLUSIONARY ALTERNATIVE	50% §65915 DENSITY BONUS ALTERNATIVE	
			BASE ZONING UNITS: 15% AT VERY LOW INCOME + 5% AT LOW INCOME	BASE ZONING UNITS: 15% AT VERY LOW INCOME + 10% AT LOW INCOME
<u>Project Description</u>				
Site Area (Sf)	21,780	21,780	21,780	21,780
Density (Units/Acre)	60	60	90	90
Unit Mix				
Studio/SRO Units	15	15	22	22
One Bedroom Units	12	12	18	18
Two Bedroom Units	3	3	5	5
Total Units	30	30	45	45
Parking Spaces Per Unit	1.10	1.10	0.51	0.51
<u>Development Costs</u>				
Property Acquisition Costs	\$2,178,000	\$2,178,000	\$2,178,000	\$2,178,000
Construction Costs	14,679,000	14,667,000	21,508,000	21,505,000
Total Development Cost	\$16,857,000	\$16,845,000	\$23,686,000	\$23,683,000
Per Square Foot of Land Area	\$561,900	\$561,500	\$526,400	\$526,300
Stabilized Net Operating Income	\$793,000	\$728,600	\$1,086,400	\$1,064,900
<u>Total Financial Impact</u>				
Required Prop Acq Cost Reduction (\$)		\$1,357,000	\$592,000	\$1,046,000
Required Prop Acq Cost Reduction (%)		62%	27%	48%
% Rent Increase to Offset Impact		8.7%	2.3%	4.3%

SRO APARTMENT PROTOTYPE

The analysis of the SRO Apartment Prototype is presented in Attachment 3 – Appendix D. The results are summarized in the following table:

SRO Apartment Prototype Base Case Density: 125 Units/Acre Apartment Development Prototypes				
	MARKET RATE ALTERNATIVE	20% LOW INCOME INCLUSIONARY ALTERNATIVE	50% §65915 DENSITY BONUS ALTERNATIVE	
			BASE ZONING UNITS: 15% AT VERY LOW INCOME + 5% AT LOW INCOME	BASE ZONING UNITS: 15% AT VERY LOW INCOME + 10% AT LOW INCOME
Project Description				
Site Area (Sf)	32,670	32,670	32,670	32,670
Density (Units/Acre)	125	125	188	188
Unit Mix				
Studio/SRO Units	94	94	141	141
One Bedroom Units	0	0	0	0
Two Bedroom Units	0	0	0	0
Total Units	94	94	141	141
Parking Spaces Per Unit	1.00	1.00	0.50	0.50
Development Costs				
Property Acquisition Costs	\$3,267,000	\$3,267,000	\$3,267,000	\$3,267,000
Construction Costs	36,597,000	36,572,000	53,283,000	53,276,000
Total Development Cost	\$39,864,000	\$39,839,000	\$56,550,000	\$56,543,000
Per Unit	\$424,100	\$423,800	\$401,100	\$401,000
Stabilized Net Operating Income	\$1,822,100	\$1,724,100	\$2,505,200	\$2,479,400
Total Financial Impact				
Required Prop Acq Cost Reduction (\$)		\$2,119,000	\$1,741,000	\$2,299,000
Required Prop Acq Cost Reduction (%)		65%	53%	70%
% Rent Increase to Offset Impact		5.6%	2.8%	3.9%

C. Findings: Apartment Development Analysis

The financial impacts created by the Inclusionary Housing alternatives tested in this analysis are presented in the following table:

Estimated Financial Impacts Apartment Development Prototypes			
	High Density - Traditional Apartment Prototype	Medium Density - Traditional Apartment Prototype	SRO Apartment Prototype
<u>20% Inclusionary Requirement - Base Zoning Alternative</u>			
Required Prop Acq Cost Reduction	224%	62%	65%
% Rent Increase to Offset Impact	10.7%	8.7%	5.6%
<u>20% Inclusionary Requirement - Density Bonus Alternative</u>			
Required Prop Acq Cost Reduction	80%	27%	53%
% Rent Increase to Offset Impact	2.3%	2.3%	2.8%
<u>25% Inclusionary Requirement - Density Bonus Alternative</u>			
Required Prop Acq Cost Reduction	141%	48%	70%
% Rent Increase to Offset Impact	4.3%	4.3%	3.9%

The following conclusions can be derived from the apartment development analyses:

1. 20% Low Income Inclusionary Housing Requirement:
 - a. At the base zoning standard, it is currently not financially viable to develop an apartment project that includes a 20% Inclusionary Housing component.
 - b. The use of the Section 65915 density bonus materially enhanced the viability of the three apartment development prototypes that fulfilled a 20% Inclusionary Housing requirement. Each prototype met the established rent offset benchmark, and one prototype also met the property acquisition cost reduction benchmark.
2. None of the three apartment development prototypes achieved viability if the Inclusionary Housing requirement is increased to 25%.

It is important to consider that the Inclusionary Housing requirement was increased from 15% to 20% effective in February 2020. Since then, the market rate apartment projects that have entered into the approval process can be described as follows:

1. Only one market rate apartment development has commenced construction under the 20% requirement, and that was a small project with a two unit Inclusionary Housing obligation. The developer also included three ADUs to the mix to make the project more financially viable.
2. Building permits are being pursued for apartment developments at 530 Front Street and 719 Darwin Street. Construction has not commenced on either of these developments.
3. The Front/Riverfront project located at 418, 440, 504, and 508 Front Street is currently under development:
 - a. The project is subject to the former 15% Inclusionary Housing requirement;
 - b. The developer obtained a subdivision map that allows the units to be sold; and
 - c. The developer plans to rent the units upon completion.

By definition, 100% affordable housing projects are not impacted by changes in the Inclusionary Housing requirements. These developments achieve financial feasibility through using a range of local, state and federal grants and assistance sources.

IV. OWNERSHIP HOUSING DEVELOPMENT ANALYSES

Residential development in Santa Cruz has been dominated by the construction of apartments through several real estate cycles. A number of the proposed apartment developments have obtained subdivision tract maps that will allow the units to be sold as condominiums. However, to date developers have opted to rent the units upon completion.

KMA created two condominium prototypes based on the characteristics of recently proposed mapped apartment projects. KMA also created a townhome prototype based on recently proposed and developed projects. The characteristics of the ownership housing prototypes are described in the following table:

Project Descriptions Ownership Housing Development Prototypes					
Alternative	Site Area (Acres)	Base Zoning		Section 65915 Density Bonus	
		Density (Units / Acre)	Total Number of Units	Density (Units / Acre)	Total Number of Units
High Density	1.0	125	125	169	169
Low Density	2.0	30	60	45	90
Townhome	2.3	15	35	NA	NA

A. Pro Forma Organization and Assumptions

MARKET RATE SCENARIOS

The 100% market rate unit ownership housing development scenarios provide baselines against which to measure the impacts created by affordable housing requirements. The pro forma analyses for the 100% market rate unit scenarios are organized as follows:

Pro Forma Analysis – 100% Market Rate Scenario Ownership Housing Development Prototypes	
Table 1:	Estimated Development Costs
Table 2:	Projected Net Sales Revenue
Table 3:	Projected Developer Profit

The estimated developer profit for each of the 100% market rate scenarios is used as the benchmark profit percentage for the purpose of estimating the impacts created by the imposition of Inclusionary Housing obligations. The resulting financial gaps represent the impact created by the requirements being tested.

AFFORDABLE HOUSING SCENARIOS

The pro forma analyses for the affordable housing scenarios are organized as follows:

Pro Forma Analyses - Affordable Housing Alternatives Ownership Housing Development Prototypes	
Table 1:	Estimated Development Costs
Table 2:	Projected Net Sales Revenue
Table 3:	Financial Impacts: Inclusionary Housing Requirements

KMA measured the financial impacts created by the imposition of Inclusionary Housing requirements using the tools described previously in this Financial Evaluation. These tools were used to identify the moderate income and very low income requirements that can be feasibly imposed on ownership housing developments.

The “Affordable Sales Price” calculation methodology is described in Attachment 2: Appendix B and the Affordable Sales Price calculations are detailed in Attachment 4: Appendix B. The results are presented in the following table:

Affordable Sales Prices Ownership Housing Development Prototypes		
Number of Bedrooms	Inclusionary Housing Moderate Income 110% of AMI	Section 65915 Very Low Income 50% of AMI
Studio	\$296,600	\$62,400
1	\$341,200	\$73,400
2	\$367,400	\$67,900
3	\$407,100	\$63,000

B. Alternatives Testing

HIGH DENSITY CONDOMINIUM PROTOTYPE

The analysis of the High Density Condominium Prototype is presented in Attachment 4 – Appendix C. The results are summarized in the table on the following page:

High Density Condominium Prototype Base Case Density: 125 Units/Acre Ownership Housing Development Prototypes				
	MARKET RATE ALTERNATIVE	20% MODERATE INCOME INCLUSIONARY ALTERNATIVE	35% §65915 Density Bonus Alternative	
			20% MODERATE INCOME INCLUSIONARY ALTERNATIVE	25% MODERATE INCOME INCLUSIONARY ALTERNATIVE
			BASE ZONING UNITS: 11% @ VERY LOW INCOME + 9% @ MODERATE INCOME	BASE ZONING UNITS: 11% @ VERY LOW INCOME + 14% @ MODERATE INCOME
<u>Project Description</u>				
Site Area (Sf)	43,560	43,560	43,560	43,560
Density (Units/Acre)	125	125	169	169
<u>Unit Mix</u>				
Studio Units	31	31	42	42
One-Bedroom Units	63	63	85	85
Two-Bedroom Units	31	31	42	42
Three-Bedroom Units	0	0	0	0
Total Units	125	125	169	169
Parking Spaces Per Unit	1.25	1.25	0.63	0.63
<u>Development Costs</u>				
Property Acquisition Costs	\$4,356,000	\$4,356,000	\$4,356,000	\$4,356,000
Construction Costs	80,728,000	80,462,000	107,385,000	107,287,000
Total Development Cost	\$85,084,000	\$84,818,000	\$111,741,000	\$111,643,000
Per Unit	\$680,700	\$678,500	\$661,200	\$660,600
Net Revenue	\$90,104,000	\$80,054,000	\$108,270,000	\$106,031,000
Developer Profit / (Loss)	5.9%	-5.6%	-3.1%	-5.0%
<u>Total Financial Impact</u>				
Required Prop Acq Cost Reduction (\$)		\$9,768,000	\$10,064,000	\$12,199,000
Required Prop Acq Cost Reduction (%)		224%	231%	280%
% Market Price Increase to Offset Impact		13%	9%	12%

LOW DENSITY CONDOMINIUM PROTOTYPE

The analysis of the Low Density Condominium Prototype is presented in Attachment 4 – Appendix D.

The results are summarized in the following table:

Low Density Condominium Prototype Base Case Density: 30 Units/Acre Ownership Housing Development Prototypes				
	MARKET RATE ALTERNATIVE	20% MODERATE INCOME INCLUSIONARY ALTERNATIVE	50% §65915 Density Bonus Alternative	
			20% MODERATE INCOME INCLUSIONARY ALTERNATIVE	25% MODERATE INCOME INCLUSIONARY ALTERNATIVE
			BASE ZONING UNITS: 15% @ VERY LOW INCOME + 5% @ MODERATE INCOME	BASE ZONING UNITS: 15% @ VERY LOW INCOME + 10% @ MODERATE INCOME
<u>Project Description</u>				
Site Area (Sf)	87,120	87,120	87,120	87,120
Density (Units/Acre)	30	30	45	45
<u>Unit Mix</u>				
Studio Units	0	0	0	0
One-Bedroom Units	18	18	27	27
Two-Bedroom Units	30	30	45	45
Three-Bedroom Units	12	12	18	18
Total Units	60	60	90	90
Parking Spaces Per Unit	1.30	1.30	0.66	0.66
<u>Development Costs</u>				
Property Acquisition Costs	\$8,712,000	\$8,712,000	\$8,712,000	\$8,712,000
Construction Costs	52,319,000	52,138,000	91,653,000	91,653,000
Total Development Cost	\$61,031,000	\$60,850,000	\$100,365,000	\$100,365,000
Per Unit	\$1,017,200	\$1,014,200	\$1,115,200	\$1,115,200
Net Revenue	\$68,295,000	\$58,955,000	\$90,538,000	\$88,215,000
Developer Profit	11.9%	-3.1%	-9.8%	-12.1%
<u>Total Financial Impact</u>				
Required Prop Acq Cost Reduction (\$)		\$9,137,000	\$21,773,000	\$24,096,000
Required Prop Acq Cost Reduction (%)		105%	250%	277%
% Market Price Increase to Offset Impact		15.8%	23.1%	26.6%

TOWNHOME PROTOTYPE

The analysis of the Townhome Prototype is presented in Attachment 4 – Appendix E. The results of the analysis are summarized in the following table:

Townhome Prototype Base Case Density: 15 Units/Acre Ownership Housing Development Prototypes			
	MARKET RATE ALTERNATIVE	20% MODERATE INCOME INCLUSIONARY ALTERNATIVE	25% MODERATE INCOME INCLUSIONARY ALTERNATIVE
<u>Project Description</u>			
Site Area (Sf)	100,000	100,000	100,000
Density (Units/Acre)	15	15	15
Unit Mix			
Studio Units	0	0	0
One-Bedroom Units	9	9	9
Two-Bedroom Units	26	26	26
Three-Bedroom Units	0	0	0
Total Units	35	35	35
Parking Spaces Per Unit	1.74	1.74	1.74
<u>Development Costs</u>			
Property Acquisition Costs	\$10,000,000	\$10,000,000	\$10,000,000
Construction Costs	24,708,000	24,716,000	24,776,000
Total Development Cost	\$34,708,000	\$34,716,000	\$34,776,000
Per Unit	\$991,700	\$991,900	\$993,600
Net Revenue	\$37,504,000	\$32,443,000	\$30,842,000
Developer Profit	8.1%	-6.5%	-11.3%
<u>Total Financial Impact</u>			
Required Prop Acq Cost Reduction (\$)		\$5,070,000	\$6,735,000
Required Prop Acq Cost Reduction (%)		51%	67%
% Market Price Increase to Offset Impact		15.9%	22.9%

C. Findings: Ownership Housing Development Analysis

The City's Inclusionary Housing program, as detailed in Municipal Code Chapter 24.16, requires that ownership housing developments with five or more units must allocate 20% of the units to low and moderate income households. However, the Chapter does not identify a required allocation between

low and moderate income units. For the purposes of this analysis, KMA assumed that the entire obligation can be fulfilled with moderate income units.

The key finding of the analysis is that condominium and townhome development is not currently financially viable if any affordable housing requirements are imposed. The analyses indicate that 100% market rate projects could potentially be supported, but even the imposition of a moderate income requirement generated negative profit in all the ownership housing prototypes that were tested. The loss would be even larger if a low income requirement is applied.

Based on the analyses, it is KMA's conclusion that the existing 20% Inclusionary Housing cannot be supported under current economic conditions. This conclusion is supported by the fact that no market rate ownership developments that are subject to 20% Inclusionary Housing requirement have commenced construction. If the obligation is increased to 25% the constraint would be even greater.

As discussed previously, a number of proposed apartment developments have obtained subdivision tract maps that will allow the units to be sold as condominiums at some point in the future. One likely reason that developers have opted to rent the units upon completion is that under current conditions apartment development is more profitable than condominium and townhome development.

V. FINANCIAL EVALUATION CONCLUSIONS

There is very little vacant developable land left in Santa Cruz. As a result, the majority of recent new residential development has been occurring on properties that are developed with existing improvements. The Housing Element makes the fundamental assumption that this will continue to be the case. For this to occur, the property value supported by residential development must be competitive with the other opportunities available to property owners.

Based on the results of the pro forma analyses, KMA reached the following conclusions:

1. Apartment Development:

- a. Under current conditions, the existing 20% Inclusionary Housing requirement can only be supported if the project can make use of the Section 65915 density bonus on a cost efficient basis.
- b. A 25% Inclusionary Housing requirement could not be supported by any of the apartment prototypes even it was assumed that the maximum Section 65915 density bonus was applied.

2. Ownership Housing Development:

- a. Under current conditions ownership housing development cannot support an affordable housing requirement of any kind.
- b. It is possible that developers of some mapped apartment projects may ultimately sell the units. However, the opportunities for this to occur will be constrained by the imposition of the current 20% Inclusionary Housing obligation. This constraint will be exacerbated if the Inclusionary Housing requirement is increased to 25%.

It is important to remember that the courts and the State legislature have imposed the following requirements on Inclusionary Housing programs:

1. Inclusionary Housing requirements cannot be confiscatory;
2. Inclusionary Housing requirements cannot deprive a property owner of a fair and reasonable return on investment; and
3. Inclusionary Housing requirements cannot act as a constraint to housing development.

Base on the assumptions and analysis presented in the Financial Evaluation, KMA reached the following conclusions:

1. The Measure M requirement to increase the Inclusionary Housing obligation to 25% for projects with 30 or more units does not comport with any of the requirements imposed by the courts and the State Legislature.
2. Given the financial impacts created by the proposed increase in the Inclusionary Housing obligations, residential development will not be competitive with the other disposition or holding opportunities available to property owners.
3. If Measure M passes, significant potential exists for legal challenges from residential developers and/or an HCD constraint to housing investigation. This could possibly result in the decertification of the City's Housing Element.