GENERATION Housing ACTION PLAN

Incentivize Affordability

POLICY BRIEF

Generation Housing Action Plan is our policy platform designed to accelerate housing production through concrete and straightforward plans. This brief highlights one of five action steps that outlines how to jumpstart local homebuilding immediately.

Impact Fee Relief as Gap Financing for Affordable Housing

The funding of Affordable housing is a singular challenge for local jurisdictions. Despite the pressing need to add low-income housing, deed-restricted Affordable housing remains underbuilt across the state. In the last eight years, for every 100 homes permitted in Sonoma County, nearly 70 were designated for households earning above 120% of the Area Median Income.[1] Deed-restricted units formed only 11 percent of all rental housing inventory throughout the county as of 2021.[2]

Cities rely on multiple tools to close that funding gap for Affordable housing, but one tool that remains overlooked and underutilized is *impact fee relief*, which can incentivize the type of housing we need most and will serve our lower-income residents. (See Table 1 for a summary of key terms on the topic of Affordable housing finance and fees.) Impact fees are levied upon new development and help fund new infrastructure, such as parks, roads, and community facilities. But they also add costs to new construction—costs which, in a constrained housing market, are absorbed mostly by future residents. The structure of impact fee schedules also means that for smaller multifamily units, which make up most deed-restricted Affordable housing, fees constitute a large fraction of each unit's cost. According to the Terner Center for Housing Innovation at UC Berkeley, this "considerably lower[s]" the chances of Affordable housing being built without requiring higher rents;[3] even an additional cost of up to $20,000 per unit can make the difference in whether a project can be built.[4] In Sonoma County many fees total over $1,000,000 per multifamily project.

TABLE 1. AFFORDABLE HOUSING AND IMPACT FEE FAQ

What is Affordable housing?
Deed-restricted (i.e. "capital-A" Affordable) housing refers to any housing unit reserved for lower or moderate income households through a government subsidy, affordability incentive, or inclusionary zoning requirement. These households must earn no more than 120 percent of the Area Median Income.

What are impact fees used for?
Impact fees are used to create new parks, build community facilities, improve transportation infrastructure, and help finance Affordable housing. Park and traffic mitigation fees tend to have larger balances, but there is significant variation in fee collection between jurisdictions—many jurisdictions decline to collect fees at all in categories such as community facilities.

How are impact fees different from taxes?
Taxes are collected from a variety of sources and jurisdictions may use tax revenue for any governmental purpose. Impact fees, meanwhile, can only be collected on new development and used to fund the infrastructure needed to accommodate those new residents.

How do cities set impact fees?
Cities conduct nexus studies to estimate the infrastructure usage of new development and the cost associated with that increased usage. These nexus studies lay out the maximum allowable impact fee that can be charged to different kinds of development. Cities frequently set their fees below the maximum and give additional fee reductions to projects in certain areas or that serve lower-income residents.

A practical example of fee relief as a powerfully effective and efficient investment into Affordable housing construction comes from the city of Sacramento. In 2019, Sacramento instituted a program to reduce all City-controlled impact fees on regulated/deed-restricted Affordable housing units to $0.[5] Results far exceeded expectations: while the City expected only 100 Affordable dwelling units to take advantage of the program, in the three and a half year period following implementation, 2,076 Affordable units were permitted.[6] Even more astonishing was the program's cost-effectiveness: the impact fee revenue that the city forgoed to invest into Affordable housing totaled only $7.4 million,[7] or just ˜$3,600 per unit.

This brief will outline how impact fee relief remains an overlooked tool that, if offered in targeted ways, can both incentivize and effectively bridge the final funding gaps of Affordable housing projects. In Sacramento's case, the amazing success of their fee waiver program led city officials to approve an annual $3 million transfer to impact fee funds until 2028 to continue financing the waiver.[8] Petaluma implemented a similarly strong waiver in November 2022 to further align itself with its own Affordable housing goals.[9] Sonoma County jurisdictions have a powerful opportunity to leverage an overlooked and atypical revenue source towards their pro-housing priorities.

Reliance on Impact Fees Since 1978: An Experimental Approach to Municipal Financing with Untested Consequences for Housing

Impact fees arose out of an attempt for cities to balance their budgets following the passage of Proposition 13 in 1978. Property tax revenues were slashed by 57 percent overnight,[10] forcing cities to turn to an ad-hoc and untested form of revenue to fund infrastructure needs: development impact fees.[11] Since fees are not technically taxes—they are used to directly recoup the cost of a government providing a service, instead of being available for general public use[12]—regulation around fees was limited and there were many opportunities for unjustified charges or misuse.[13] Legislation and debate around impact fees immediately arose, both in California and nationwide, in the years after impact fees became popular. In 1987, the California Legislature sought to clarify and standardize practices around impact fees, ultimately passing AB 1600,[14] also known as the Mitigation Fee Act.[15] Meanwhile, arguments abounded about the economic, legal, and moral ramifications of impact fees. These arguments continue to this day,[16] as impact fees have become a contentious method of financing infrastructure and directing new development that pits new housing and new infrastructure against each other in a zero-sum game.

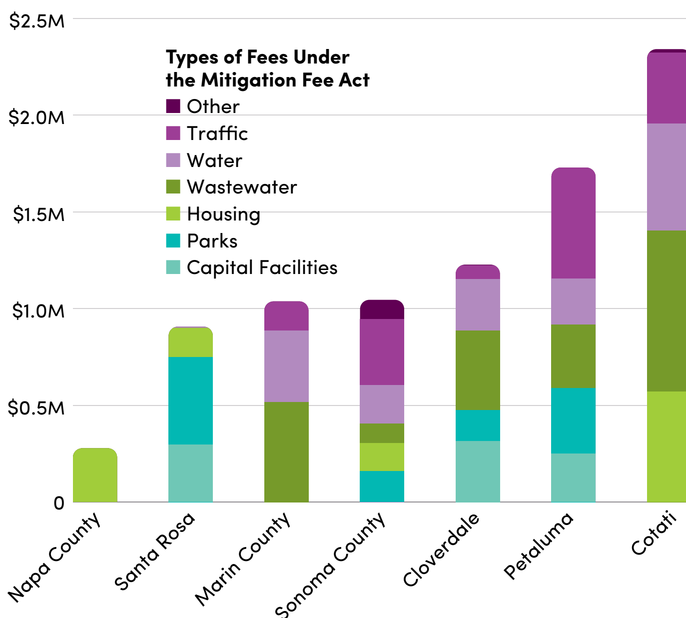

Figure 1. Sonoma County fees are high, as illustrated by fees charged for a prototypical 50-unit multifamily project.

Source: Generation Housing analysis. Total fees are estimated from jurisdictional 6th Cycle Housing Elements.

Impact fees are particularly onerous and controversial in California. Our state has the highest impact fees in the country, double that of second place Maryland, likely due to the unique consequences of Proposition 13.[17] (See Figure 1 on a Total Mitigation fee samples of North Bay jurisdictions.)[18]

Impact fees are highly regressive. Fees are typically levied on a per-unit basis, meaning that "apartment fees are considerably higher than subdivision and infill home fees" and smaller units pay the highest percentage of their total costs in fees.[19] This hurts the production of both Affordable and affordable-by-design housing, as both rely on smaller unit sizes in order to charge lower prices to residents.[20] While impact fee policy might not have the same discriminatory intent of past redlining practices, because the large majority of Affordable and affordable-by-design multifamily housing serves low wage earners, younger families, and people of color, it is yet another land use policy that weighs most heavily on working class and marginalized communities.

Moreover, these disproportionate fees place the burden for funding infrastructure on new residents exclusively, regardless of whether they live in more sustainable, higher density configurations or low-density neighborhoods, which havegreater per-capita energy and road usage. With few stipulations on how fees must be spent, revenue-funded projects can serve a wide variety of functions—some more necessary than others. In recent years, projects such as marinas, which serve limited populations, have been supported by fees charged only to developers and new residents. Fees are also an imperfect way of linking revenues to expenditures. As California's Department of Housing and Community Development warned, the difficulty predicting what spending will be needed in the future could result in a "weak link" between fees and long term capital improvements, making it difficult to justify current fee rates and leading to the surplus funds we see today (discussed below).[21] Because fees function as non-fungible revenue sources that can only be allocated to non-maintenance infrastructure spending, cities lock themselves into theorized future additions. Fee revenue cannot be redistributed to serve other types of needs as they arise nor can they be redirected towards non-infrastructure uses should population growth stagnate—

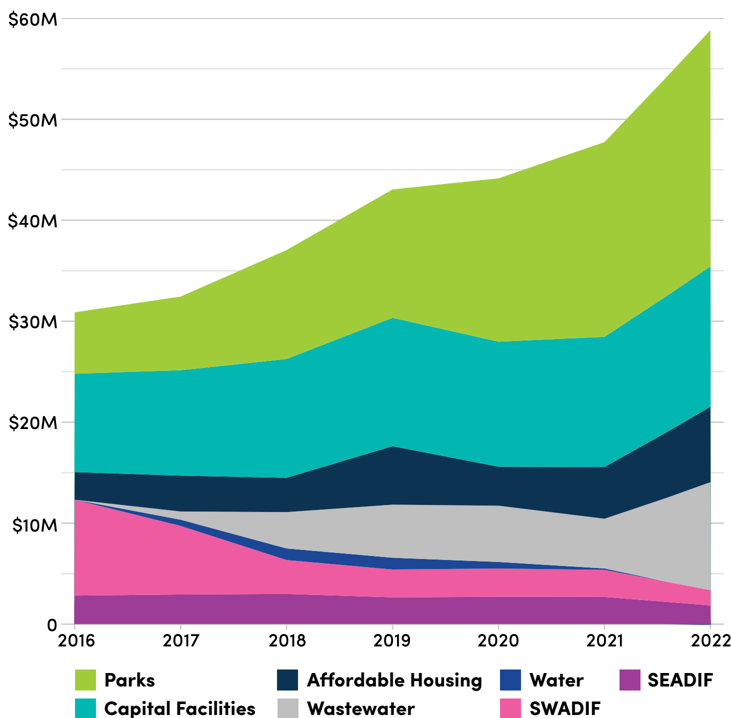

Figure 2. Santa fee reserves doubled to $60M over fiscal years 2016-2022, with park fee reserves growing fastest.

Source: Generation Housing analysis. City of Santa Rosa, Annual Development Fee Reports. Note: SEADIF and SWADIF represent the Southeast Area and Southwest Area Development Impact Fee funds, respectively. They began phasing out in 2018.

ensuring long periods of time when revenues outpace spending.[22] (See Figure 2 on Santa Rosa's growing surplus-per-capita fee revenue.)

Fees also make up a larger portion of the total cost of Affordable housing projects, which according to the Bay Area Economic Council, typically run about $497,000 per unit in Sonoma County.[23] Fees in Sonoma County can run anywhere from $1.4 to $1.7 million on a typical 50-unit project.[24] According to the Terner Center, high per-unit fees "can also have more significant consequences, such as incentivizing developers to build fewer units… to avoid paying higher total per-unit fees."[25]

For these and other reasons, cities looking to immediately spur production should consider becoming less dependent on regressive fees that are hard to pre-allocate and spend down in a timely manner and instead consider re-investing these funds into Affordable housing.

Why Fee Relief Is an Affordable Housing Finance Method: The Case of Sacramento

Development impact fees are better understood as presenting an investment choice for cities: they can either be set aside as use-restricted funds for infrastructure whose term and details are unspecified; or they can be restored or refunded to specific housing types now to help them close funding gaps in the short term. Whereas the former use ties city funds up until population growth or city aging demands new additions, most jurisdictions in California face housing deficits whose costs can be seen now. In the face of this choice, the Sacramento City Council decided to fall firmly on the side of addressing the deficit of Affordable housing.

Sacramento was far underperforming its low-income housing goals prior to 2019. Between 2013 and 2019 the city permitted 486 Low Income units (212 deed-restricted) and 255 Very Low income units (151 deed-restricted), in total making up just 14 percent and 5 percent of their 5th cycle RHNA goals, respectively, six years into the eight-year cycle.[26] In response, the city passed a "Zero-Dollar Rate" Affordable housing fee waiver: this program charges a $0 rate for City-controlled impact fees for any regulated/deed-restricted Affordable housing unit. As this included utility connection fee waivers along with park, traffic, and city facilities waivers, and was granted at a per-unit rather than per-project basis, this program represented the broadest possible fee waiver for Affordable housing. Though the program waived fees for units deed-restricted to moderate income households—those earning 120 percent of the Area Median Income—the vast majority of units were restricted to low and very low income households.[27]

City leaders correctly identified the usage of impact fees as an opportunity cost where they sacrificed funding for Affordable housing. Consequently, they framed their relief policy as a restoration of funds towards housing, and not merely as a diversion of funds away from "financ[ing] the design, construction, installation, and acquisition of public infrastructure."[28] What they did not anticipate was the success of the program: in comparison to the 363 deed-restricted units built in the first six years of the 5th cycle, the city permitted 1,061 deed-restricted units in the last two years of the cycle. The city built three times the number of Affordable units in one-third of the time after passage of fee relief, far exceeding their initial expectations of just 100 units. Crucially, as demonstrated by Figure 3, increased Affordable housing production was not tied to an increase in non-deed-restricted housing, suggesting that the targeted fee relief alone was responsible for the higher production.

More impressive than the production numbers was the cost to the city. Staff estimated that total revenues restored to housing development totaled around $8 million dollars, some of which was covered by grants.[29] For the price of $7 million in unrealized revenues, the city had helped realize an additional 2,000 Affordable units—a cost-efficient outlay of just $3,000-$4,000 per unit.

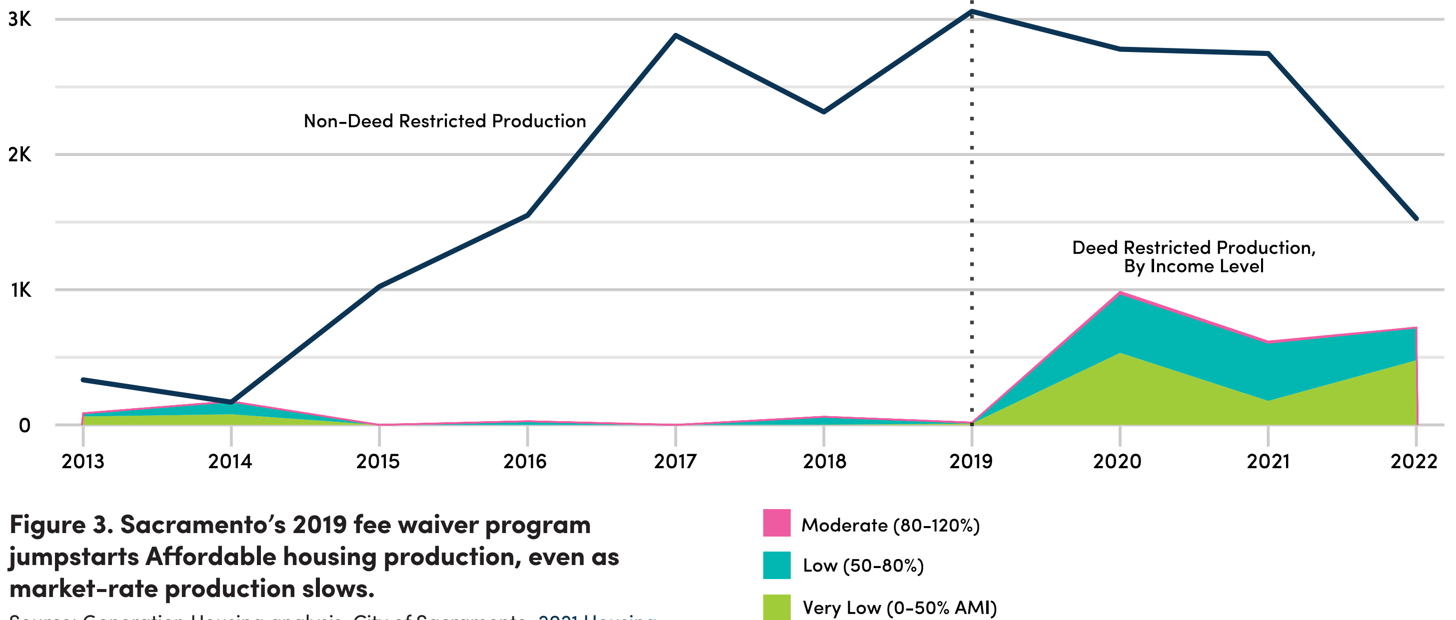

Figure 3. Sacramento's 2019 fee waiver program jumpstarts Affordable housing production, even as market-rate production slows.

Source: Generation Housing analysis. City of Sacramento, 2021 Housing Element Annual Progress Report and 2022 Housing Element Annual Progress Report.

Following early success, staff conducted a survey of fee reduction program participants to better understand how the program had achieved these outcomes. Most of the respondents agreed that the fee reduction program helped their organization construct Affordable dwelling units in Sacramento. Project savings ranged from $400,000 in total fees for a 159-unit development to $450,000 for a 53-unit Affordable housing development aimed at seniors.[30]

Even with unrealized infrastructure funds, Sacramento has indicated intentions to continue the fee waiver program, allocating $3,000,000 for 2023/24 to support this investment in Affordable Housing.[31] City officials even "urged the Sacramento City Unified School District and the Sacramento Regional County Sanitation District and other government agencies to follow suit by waiving their fees for new Affordable housing."[32]

How We Can Reduce Fees Using Lessons Learned from Sacramento

Sacramento's success can be replicated in Sonoma County. Leveraging policy pathways permitted by the Mitigation Fee Act and making strategic use of fee waiver authority, Sonoma County jurisdictions can make an immediate impact on Affordable housing financing. Following our policy recommendations below, we project that cities can mirror the success of trial periods such as that in Sacramento through targeted, three-year relief on most fees for deed-restricted Affordable housing serving residents up to 120 percent AMI.

We Have the Revenue Surplus to Sustain a Three-Year Fee Relief

Though it may seem unexpected, Sonoma County jurisdictions have the money available to fund a similar fee waiver program, thanks to large balances and steady surpluses in their impact fee funds. Each year, California jurisdictions are required to publish reports on the amount of impact fees collected, spent, and accumulated.[33] Where these reports are available, we demonstrate in Figure 4 that jurisdictions have large sums—up to the tens of millions—and that even in years where expenditures are large, revenues are almost always larger. Importantly, these funds have restricted uses: as per the MFA, impact fee funds can only be used to construct new infrastructure and cannot be used for the repair or maintenance of existing infrastructure, which contributes to surplus growth. As shown in Figure 4, Petaluma's accumulated per-capita revenue from impact fees nearly doubled since 2015, from $429,000 in surplus dollars per 1,000 residents to nearly $809,00 per 1,000 residents last year. Cities are permitted to collect fees to address increased demand on infrastructure even in periods of negative population growth. It is in this context that Petaluma identified an opportunity to reduce fees without jeopardizing its significant reserves, opening up opportunities to support affordable housing.

The choice cities face is not between maintaining infrastructure and building housing, but between new housing now and adding reserve funds to our existing surplus. Importantly, reducing fees on housing has no impact on day-to-day operations or maintenance of infrastructure. Unlike general fund monies, which are like cash in the pockets of jurisdictions, impact fee

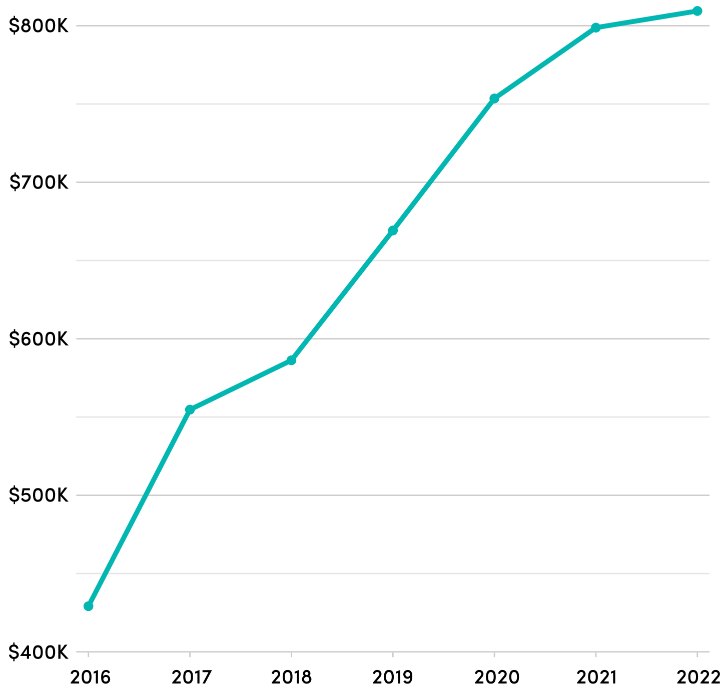

Figure 4. Petaluma's fee reserves grow to over $800K per thousand residents on the eve of fee waiving in 2022.
Source: Generation Housing analysis. City of Petaluma, Annual Development Fee Reports.

monies are like gift cards that can only be spent on new infrastructure in the future. Compared to long-held surplus dollars tied to limited infrastructure uses, small amounts of fee relief have large impacts on housing. For example, waiving the total impact fees for a 50-unit multifamily project in Santa Rosa is equivalent to the cost of repaving a single block of road or "re-imaging" a single lot park—each of which total between $830,000-$880,000 per project.[34]

Cities Have the Authority to Act Now and the Space to Reduce Fees

Cities implicitly acknowledge the inefficiency of fees as a singular method of financing infrastructure. Most regularly set fee rates below the allowable maximum as defined by their Nexus studies.[35] This demonstrates that cities have the legal capacity and fiscal room to raise or lower fees without a new nexus fee study.

There is room to be strategic with fees, which are not currently targeted in the most efficient ways. Sonoma County's fees on market-rate housing are well in line with regional rates, but they deploy fewer exceptions for Affordable housing—limiting waivers to narrow geographic zones or offering relief on specific subsets of fees or additional floors. For example, current fee waivers on Affordable units in Santa Rosa's Downtown Station Area are limited to capital facilities and park fees (and only for buildings that have at least two to three residential floors).[36] When the waivers, under the High Density Multi-Family Residential Incentive Program, were first implemented in 2018, the City estimated that a typical, Affordable project built in the Downtown could save $11,567 to $12,100 in capital facilities and park fees per unit, provided they built the maximum allowable floors.[37] Each unit would effectively pay only $1,067 to $1,600 in capital and park fees. Even so, an Affordable project claiming the largest possible per-unit waiver of $12,100 would only reduce their per-unit fees by 42 percent compared to a similar market-rate project paying $29,057, as both projects would still have to pay significant water, wastewater, and mandatory school district fees.

Fee Relief Must Be Comprehensive Rather than Piecemeal

Sacramento's outlays demonstrate that even a small per-unit relief strategy through wholesale waivers can lead to significant gains in Affordable housing production. The average waiver of roughly $3,500 per unit appeared to be sufficient to close the gap in financing in order to realize the type of deed-restricted Affordable units it had under-built for years.

This wholesale approach to fee relief has the benefit of allowing for cities to make a significant dent in existing deficits. Utilizing a trial period during which fees are eliminated for Affordable units can result in a large enough surge in production to cut deficits by thousands of units. Our policy recommendations aim for higher production would result fromalternative plans for partial fee reductions based on unit size or unit equivalency rates.

Opportunities to Offset Lost Revenue in Advance

Sacramento has learned lessons from its first trial period and has now optioned to pre-allocate funds from other city sources in order to compensate for revenue typically earned through fee collection. In the case of cities like Santa Rosa, it's clear from published fund balances that pre-allocation can make up for anticipated declines in revenue. For example, revenue from impact fees on market-rate and Affordable housing constituted an average of 3.3 percent of Santa Rosa's annual revenue from 2015-2022. Affordable units are only a fraction of new housing units, and the 289 units built in the last two years represent fees of around $10 million, after adjusting for inflation-indexed fee increases since 2018. Had the City waived those fees over the last two years, as it would have under our policy program, it could have attracted more Affordable and workforce housing.

Lost revenue would also be offset by increasing property tax revenue and attracting tax-paying residents, employees in needed sectors, and student enrollment in school districts.

Conclusion

In recent years, cities across the state have utilized their power over fees to close the gap in financing that plagues Affordable housing. They have come to view fee relief not only as an efficient use of funds to support Affordable housing in the short-term, but as a moral imperative to redirect investments towards housing rather than housing-related infrastructure. Jurisdictions like Sacramento, San Jose, Oakland, Petaluma, Fresno, and San Mateo have all taken steps to reduce their cumulative deficit. Most have refused to view fee relief as a sacrifice. As one representative from Fresno has stated, "The fee waiver program is actually not a waiving of fees."[39] By pre-allocating millions of dollars in the budget process to pay for the fees for infill housing projects, Fresno views fee relief as another mode of investment rather than lost revenue.

Fees can and should be thoughtfully and surgically restructured to act as supports, incentives, and disincentives that align with jurisdictional needs and goals. As part of our holistic policy platform, Generation Housing Action Plan, fee relief is the best solution to offset costs at a time when elevated interest rates and rising material costs threaten to bring Affordable housing production to a halt in the county.

> *"[Affordable housing] is where we will get the most bang for the buck. There is merit to treating these projects in a very particular way because they come to us so infrequently. They are so special."*
>
> *Amourence Lee, Mayor, City of San Mateo, on the value of impact fee reductions* [38]

Your voice has POWER.

Scan the QR code to sign the petition joining this urgent call to action.

1 California Department of Housing and Community Development. Housing Element Implementation and APR Dashboard. Permits by Affordability, 5th Cycle, Sonoma County. Of 13,095 units permitted during the 5th cycle, 8,859 were above moderate income.
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8 City of Sacramento (2023). Fiscal Year 2023/24 Budget. pp. 28, 67.
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12 Spitzer, Hugh D. (2002). Taxes vs. Fees: A Curious Confusion. 38 Gonzaga Law Review 335. pp. 337-339, 343.
13 California Department of Housing and Community Development, Pay to Play, pp. 16-21.
14 Raetz, Garcia, and Decker, Residential Impact Fees in California. p. 18.
15 Gov. Code §66000 et seq.
16 For example, Petaluma and the Terner Center argue that utility connection fees do not fall under the purview of the Mitigation Fee Act, yet cities like Sacramento, in their fee waiver program, believe they do.
17 Terner Center for Housing Innovation (2019). Development Fees: Sacramento. p. 2.
18 Generation Housing analysis of 6th Cycle Housing Elements. Total impact fees cited in this chart include only those authorized by the Mitigation Fee Act and exclude service fees and school fees. Note: Santa Rosa's water, water demand, water processing, and meter fees are included under "Water"; Petaluma's open space, parkland acquisition, and parkland development fees are included under "Parks"; Sonoma County's, Cotati's, and Cloverdale's storm drain fees are included in "Other". San Rafael only collects traffic fees. Marin County has an in-lieu parking fee not reflected in this chart.
19 California Department of Housing and Community Development, Pay to Play, p. 66.
20 Lowry, John (2019). Fee and Land Use Proposal for Affordable Housing Built at Higher Densities. "Fees accoun[t] for perhaps 5% of the cost of building a large home, but in the range of 25% of the cost a studio or one bedroom apartment." p.3.
21 California Department of Housing and Community Development, Pay to Play.
22 California Special Districts Association (2018). Impact Fees: Breaking New Ground Doesn't Need to Break the Bank. CSDA notes further limitations on the use of impact fee revenue on the "reconstruction of existing infrastructure currently serving existing development."
23 Bay Area Council Economic Institute (n.d.). How Much Does it Cost to Construct One Unit of Below Market Housing in the Bay Area?.
24 Sonoma County (2023). Housing Element Technical Background Report p. 63, Table 25.
25 Mawhorter, Sarah, David Garcia, and Hayley Raetz (2018). It All Adds Up: The Cost of Housing Development Fees in Seven California Cities.
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33 Gov. Code §66006(a)
34 City of Santa Rosa Capital Improvement Program Budget FY 2022-23. p. 80 and p. 104.
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