

**San Francisco Bay Area Regional Prosperity Plan
Final Report for East Bay Housing Organizations (EBHO)**

A. Project Profile (1 page maximum)

Project Name: Implementing Land Value Recapture to Support the Production and Preservation of Affordable Housing Near Transit

Lead Organization: East Bay Housing Organizations (EBHO)

Partner Organizations: The City of Concord, City of El Cerrito, City of Walnut Creek, and City of Fremont were the leading partner organizations.

Additional partners were EBHO's membership, who engage in committees, programs, and working groups, and include non-profit affordable housing developers, architects, planners, builders, homeless service providers, advocates, financial institutions, policy experts, faith-based and community groups, city and county agencies, environmental organizations, and labor unions. EBHO also partners closely with our sister organizations in the region including Non-Profit Housing Association of Northern California (NPH), Council of Community Housing Organizations in San Francisco (CCHO), and Housing Leadership Council of San Mateo County (HLC).

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Sub-Grant Program: Housing the Workforce

Project Type: Title of Eligible Activity from Call for Proposals

- Funding Gap and Strategies Analysis
- Deed Restricted Affordable Housing Policy
- Implementation Tools

Total Grant Amount: \$50,000

Total Match (if any): **N/A**

Geographic Coverage of Project: Neighborhood / City / County / Sub-Region

The Bay Area Region in general and four East Bay cities in particular including Concord, El Cerrito and Walnut Creek (and their PDAs) in Contra Costa County, and Fremont (and their Warm Springs PDA) in Alameda County

Brief Description (150 words maximum):

The purpose of EBHO's proposed project is to provide guidance to elected officials, agency staff, and community members on an innovative method to fund affordable housing. This funding option is referred to as Land Value Recapture (LVR) as well as Public Benefits Zoning (PBZ). This method captures a portion of the increased land values created by public investment and rezonings, and targets them for affordable housing development and preservation. This approach – a market-based tool - is particularly important in light of the potential for increasing land values in Priority Development Areas (PDAs). LVR is designed for jurisdictions to attract the development they want and meet community needs, especially after the loss of Redevelopment. EBHO's work with the Cities of Concord, El Cerrito, Walnut Creek and Fremont supported their staff, provided learning opportunities for their elected officials, and built collaborative relationships with agency staff, consultants, elected officials, expert practitioners, stakeholders and grassroots leaders.

B. Project Description (1 page maximum)

1. Goals and Objectives: The goals of EBHO's project was to provide support and guidance to elected officials, agency staff, and community members on LVR/PBZ as an alternative method to fund affordable housing and to prevent displacement of lower-income and workforce households in PDAs, especially in light of the loss of Redevelopment. In the Bay Area, the SCS encourages local jurisdictions to increase the intensity and density of development in the PDAs. When local governments grant land use/zoning changes or invest in improved public facilities and infrastructure, these public actions increase land values. It is a reasonable expectation that some of the increases in value should be returned to the community in the form of community benefits, including affordable housing. LVR/PBZ can capture value from increases in land value resulting from public actions and directs it toward the production and preservation of affordable housing and community benefits.

Our aim was to change how regulatory housing policies and programs are implemented over time. LVR/PBZ, directly tied to increasing land values created by public action, is a dynamic tool that can be customized and phased in, based on market conditions and particular community needs. Our hope was to establish pilot programs in four cities to set the stage for other cities in the region to implement LVR/PBZ strategies and tools.

2. Work Plan: EBHO's key deliverable was to advance LVR as a regulatory tool in the San Francisco Bay Area for affordable housing development and displacement prevention. The project consisted of three main parts: 1) Preparation of a white paper on the theory, economics, and practice of LVR/PBZ; 2) exploring the use of LVR in four selected cities; and 3) community outreach and engagement, and trainings.

Under MTC's PDA Program, Walnut Creek, Concord, El Cerrito initiated planning processes for the preparation of Specific Plans to update zoning and revise planned growth. The City of Fremont began preparing a plan for the Warm Springs/South Fremont Community Plan. EBHO provided technical assistance and feedback to city planning staff to assess the feasibility and benefits of crafting and implementing their own LVR policies. EBHO utilized its membership including architects, non-profit developers, planners, and financial and policy experts to participate in the PDA planning processes and consult on the specifics of developing and implementing feasible and effective LVR policies and programs. We participated in Citizens Advisory Committee meetings, general community workshops and public hearings, providing testimony and written comments on LVR/PBZ. We developed our specific recommendations based on the economic and political conditions and opportunities in each city and their PDA planning process.

EBHO outreached and engaged faith and community leaders to be involved in these planning processes, and offered trainings and workshops to inform them about affordable housing policies and LVR tools. EBHO's final report offers insights and learnings from these four cities, as well as suggestions for other jurisdictions. EBHO presented our findings in several workshops and trainings with stakeholders, practitioners and policy makers, and community leaders.

3. Role of Lead and Partners: EBHO managed and oversaw implementation of the project. With the East Bay Regional Policy Committee, EBHO tapped the expertise of EBHO's membership and coordinated their participation in the planning processes in the partner cities. EBHO provided feedback and support to the planning processes, and participated in the public hearings and workshops. EBHO also outreached and engaged community members, including the faith community, to participate in these planning processes.

EBHO partnered with these four cities to evaluate LVR policies in their PDA planning processes. We offered TA and feedback, including tours and presentations. EBHO's consultants wrote and developed the white paper, worked with the four partner cities, provided testimony and trainings, and helped develop the final report. The cities worked with EBHO to explore LVR policies and led their PDA planning processes.

C. Challenges and Outcomes (1 page maximum)

4. Challenges: While the real estate market is rebounding, the local markets in Concord and El Cerrito have not yet seen significant development or investment. These markets do not yet support the level of density and intensity desired in their PDAs nor what is needed to implement LVR/PBZ. We advocated that the policies need to be established now and phased in as the market heats up, however, it is challenging to get political and community support for a future-oriented policy that won't result in immediate benefits. Both cities continue to be very supportive of affordable housing policies and have a strong partnership with EBHO. We will continue discussions.

Fremont is prioritizing commercial and jobs development that will attract tech companies and serve as an extension of Silicon Valley firms. In a very politically controversial development that has been dominated by public school interests and negotiating with the railroad, affordable housing phase-in policies have not been the focus. EBHO has been a partner to the city and a member of the stakeholder advisory group so we will continue these conversations. They have also been very supportive of affordable housing policies overall.

Walnut Creek's real estate market is hot and can support density and intensity, and LVR/PBZ. However, the West Downtown process is rezoning an already developed area with strong property interests. For example, the Almond Shuey neighborhood is in the heart of the area with 200 single family homes. The property interests dominate the discussions emphasizing what is beneficial to them now. They have shied away from higher densities and intensities, due also in part to their local height limits ordinance. In this context, it is difficult to move LVR/PBZ in the PDA but we are continuing to engage the local faith communities in advocacy as a powerful voice and grassroots constituency.

Additionally, the pressure is on for the cities to upzone their PDAs now with incentives for dense and intense development and parking reductions. If LVR/PBZ and other affordable housing and anti-displacement policies get incorporated later, it is often too late to recapture the value of the rezonings.

5. Outcomes: While the PDA processes have been limiting for the advancement of LVR/PBZ, the policy discussions have been referred over to the Housing Element process. We anticipate greater success incorporating these policies into the Housing Elements. For example, Walnut Creek included placeholder language in their Housing Element for a LVR/PBZ policy. We believe that not only will this have a greater impact in the PDAs, it will also pick up development activity citywide in other areas that should also support affordable housing and community benefits. Since it will be a more general policy, it will receive less opposition from the very specific property interests in the PDAs.

One of the most important findings is that LVR/PBZ will work best as a policy that gets phased in over time. A market trigger is less effective since by the time the market is triggered, it is too late to capture the value of the market activity. Determining the exact timing is challenging since it is based on market and economic cycles that are hard to predict. At the same time, putting a policy in place with clear timeline on phase in, is an effective signal to the market to absorb the increased costs in adjusted land values.

Finally, we have been very successful in reframing the conversations and shifting the dialogue around land value and public benefits. These cities have a deeper understanding of the range of policy interventions they can employ to meet the affordable housing needs of low-income and working families and individuals, and to mitigate against the displacement pressures caused by rezoning and public investment. In order to communicate the policy more effectively with broader audiences, we have framed it as Public Benefits Zoning rather than LVR. Additionally, faith and grassroots community leaders and advocates were engaged and empowered to be a strong voice that the benefits of growth and development should be shared by all.

D. Replicability and Dissemination (1 page maximum)

6. Replicability

The main purpose of this project is to serve as a model by providing the tools for cities and counties in the Bay area to learn about how to engage in LVR through the white paper and the experiences of four pilot cities. This learning will be made possible over time through the dissemination of the white paper and presentations to stakeholders in the region. LVR is a best practice tool that is particularly important in light of the demise of Redevelopment since it establishes new tools and approaches for communities to finance affordable housing.

Lessons learned from the participation in the planning processes in the four cities of Walnut Creek, Concord, El Cerrito and Fremont will also be disseminated to provide understanding about how different market contexts and political processes can lead to particular LVR results. The recommendations are relevant for any city that has a PDA, is conducting rezoning, or plans to allow and facilitate development and investment. EBHO will continue to share our findings in workshops and trainings with non-profit, public, and private stakeholders, affordable housing practitioners and policy makers, grassroots community groups, and impacted communities.

7. Tools and Resources

The White Paper on the Theory, Economics and Practice of Public Benefit Zoning by Nico Calavita, Professor Emeritus, and Marian Wolfe, PhD includes a number of tools and analyses. It reviews the economics, types of community benefits, and spells out the differences between PBZ and other value capture tools. It describes various implementation approaches, what happens when market conditions make it infeasible, and outlines the legal aspects. Finally, it provides four California case studies: San Francisco, Santa Monica, Culver City, and Berkeley. The final report on the four cities included in this project – Concord, Walnut Creek, El Cerrito and Fremont – outlines our experiences and lessons learned, along with a set of recommendations.

These materials are designed to assist planners and public officials, as well as community groups and advocates, in understanding the potential for this framework to create and preserve affordable housing and other community benefits.

8. Sharing and Dissemination

EBHO will disseminate this information with our members including non-profit developers, architects, planners, financial and policy experts, service providers, cities and agency staff, faith-based, grassroots and community leaders, advocates, affordable housing residents, and financial institutions. EBHO will share it with the diverse set of members, allies, and constituents that have been involved in the PDA planning processes in our partner cities. We will also share it with our sister advocacy organizations throughout the region.

Specifically EBHO will integrate these tools into the PDA and Housing Element advocacy of EBHO's East Bay Regional Policy Committee that meets monthly. EBHO will also incorporate it in our meetings with city staff. In Walnut Creek, we will use it as a resource with our EBHO sub-committee and the faith community. In Concord, we will share it with the Community Coalition for a Sustainable Concord which EBHO leads, as well as community groups and leaders in the Monument Corridor. In El Cerrito and Fremont, because the planning processes are still in their early stages, we have a great opportunity to continue to conversation with key stakeholders and constituencies, including the faith community.

On Friday, May 16th, as part of EBHO's Affordable Housing Week, we are organizing the following high profile event: Planning for a Balanced Community which will be held at City Hall in Walnut Creek. The panel will include representatives from the four partner cities who will share their experiences, and the opportunities and challenges they face incorporating PBZ into the PDA planning processes and the Housing Element.

E. Recommendations and Next Steps (1 page maximum)

9. Recommendations

10. Next Steps

EBHO will incorporate PBZ in all of our Housing Element advocacy throughout the East Bay, as well as in all of the PDA planning processes we are participating in. We will also include it in our advocacy with BART to establish an affordable housing and anti-displacement policy at BART Stations and on BART properties. Our Affordable Housing Week event, "Planning for a Balanced Community," on May 16 will facilitate further cross-learning and communication among the cities. At the regional level, the case studies of these cities will provide information and strategies that can be applied throughout the Bay Area. EBHO's final report will increase the capacity for cities, counties, and communities to incorporate LVR tools in their local and regional efforts and planning processes.

EBHO's next major step is to advocate for PBZ in a focused campaign in the City of Oakland. Oakland has a number of PDAs and is an area targeted for extensive growth and development. We are already seeing the real estate market heating up, and gentrification and displacement pressures as rents soar and homeownership fading out of reach as cash investors acquire more property. Through a follow up HUD Regional Prosperity grant, we will be engaging affordable housing residents and community members in a citywide campaign to advocate that the benefits of growth and development must be shared by all. EBHO resident leaders are passionate that development must be equitable, and that long-time residents must not be displaced. PBZ gives a tool and framework to advocate for inclusionary and anti-displacement policies. The White Paper and Final Report will be helpful resources to conduct trainings and analysis of what might be possible in Oakland.

LVR/PBZ can be applied at the local level, as it is implemented through the locally controlled land-use planning system. It is also our hope is that ABAG/MTC publicize and recommend this new tool and require localities that receive funding for PDAs planning to evaluate the potential of LVR/PBZ as a tool for increasing the production and preservation of affordable housing. For example, MTC's *Station Area Planning Manual*, under "TOD Plan Checklist" for affordable housing includes: "Plans should analyze whether higher inclusionary housing requirements can be supported in station areas" (page 24). MTC could add LVR as a tool to consider in the preparation of area plans. Congestion Management Agencies could do the same in relation to OBAG and other related funds.

Because LVR is infeasible in a number of communities in the East Bay at this time, and since it requires strong real estate submarkets, EBHO's leading recommendation is that LVR/PBZ is phased in. As the market recovers and PDAs become desirable places to live, it is important for jurisdictions to understand when and how LVR and community benefits can be phased in. The final white paper reports and final report on the four cities provide a valuable tool to understand this.

It is critical to emphasize that the main beneficiaries are those who will benefit from increased production and preservation of affordable housing, namely lower-income workers and households that would otherwise not have access to affordable non-market housing without the implementation of LVR. Additionally, as this housing will most likely be provided in close proximity to transit and jobs in PDAs, all the usual environmental and health benefits that are the result of increases of transit use and good job/housing fit will be obtained. Finally, the economies of the city in which the additional housing will be provided will benefit as well. Renters of affordable housing will have and enjoy more disposable income to spend in the local economy. Workers will have more time with their families and for civic engagement, spending less time commuting on the roads.

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East Bay Housing Organizations (EBHO)
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WHITE PAPER ON THE THEORY, ECONOMICS AND PRACTICE OF

PUBLIC BENEFIT ZONING

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About East Bay Housing Organizations:

East Bay Housing Organizations (EBHO) is a non-profit membership organization dedicated to working with communities in Alameda and Contra Costa counties to preserve, protect and expand affordable housing opportunities for the lowest income communities through education, advocacy, organizing, and coalition building. Founded in 1984, EBHO is the leading voice for affordable housing in the East Bay.



Source: Metropolitan Transportation Commission

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EXECUTIVE SUMMARY

The San Francisco Bay Area will add more than two million people by 2040. To accommodate this growth while protecting our quality of life and our environment, the Association of Bay Area Governments (ABAG) and the Metropolitan Transportation Commission (MTC) have adopted a State-mandated Sustainable Communities Strategy—a regional land use and transportation plan called Plan Bay Area. It calls for most new residential development to take place in already built up areas close to public transit. These areas are called Priority Development Areas (PDAs). Part of this strategy is to produce vibrant “complete communities” near major transit stations or hubs with a mix of commercial, civic and residential uses. The challenge is how to ensure that these communities preserve and maintain a diverse mix of residents by income, age, disability, and racial and ethnic backgrounds over the long term.

This approach towards accommodating growth has the potential to make life better and healthier for all of us, but it also has the potential to lead to a significant increase in land values for real estate investors. Compact growth—and the strategies to accommodate it—will increase land values in three ways:

- Regional and local policies that encourage new development in Priority Development Areas at the center of the Bay Area region will make the land located in these areas more valuable.
- The Bay Area region will invest billions of local and federal dollars in transportation improvements—with a significant portion going to mass transit in these central areas—thus increasing the value of properties benefitting from those investments. Economic studies have shown that when property is located near the Bay Area Rapid Transit System (BART), its value increases significantly.
- Many local jurisdictions have or will change their land use plans to accommodate greater densities in the priority areas. Increases in these densities will further increase land values.

Together, these three factors will increase land values substantially. Increased land values can have unintended consequences harmful to low- and moderate-income people living or working in the Priority Development Areas. The benefits of increased land value accrue to the landowners or the developer—who is also the land owner and do not benefit the rest of the community. These market trends can result in displacement, which in turn can mean higher housing and transportation costs, and longer commutes for those families who are forced to move. This has the potential to impact adversely the health and well-being of low-income and working families and communities of color, and minimize any reduction in greenhouse gas emissions these policies were intended to achieve.

But, there are solutions! We can have equitable, compact development, if those who profit from public actions also provide public or community benefits.

The process of requiring community benefits from landowners whose land has increased in value due to government actions is called “Land Value Recapture” (LVR). LVR is also known as Public Benefit Zoning (PBZ), Community Benefits Strategy (CBS), or Public Benefit Bonus (PBB)¹. This approach has generated great interest in the Bay Area and, to a lesser extent, in the rest of the country in the past few years, stemming from several factors, most importantly the severe fiscal crisis of government at all levels.

With climate change, higher gasoline costs, lifestyle and population changes, we are witnessing a historic shift in how land is used near transit. Public investments in transportation are increasingly moving to non-automobile choices, and land use patterns now emphasize the creation of high-density, mixed use locations and corridors served by mass transit and pedestrian and bicycle paths. All these factors lead to higher land prices.

The Economics of Public Benefit Zoning

The economics behind Public Benefit Zoning is straightforward. The easier it is to travel to a location the more desirable that location is for development, which, in turn, makes the land more valuable as well. We should remind ourselves that it has been government investment in transportation projects, from the land grants to railroad companies in the late nineteenth century, to the Federal Highway Act of 1956 to the BART system of the 1970s that improved accessibility, and expanded economic and social opportunities in the Bay Area and the country as a whole.

When land is more desirable, both private developers and public officials generally encourage higher density development which requires a change in zoning regulations. When up-zoning—or an increase in density occurs—commercial and residential land becomes more valuable because more development can occur on the same parcel of land. Some of this increase in value can be spent on public benefits under a PBZ Program.

What are the prospects of a Public Benefits strategy in the Bay Area at this particular time? To succeed, a Public Benefits policy only works in a strong, or at least stable, real estate market. Another necessary condition is that properties have not yet been up-zoned. While land values in central locations, such as PDAs, might increase on the basis of the expectation that densities will be allowed to increase, it is at the time of plan change or up-zoning that those values are solidified.

With up-zoning, the possible revenues—due to the ability to construct additional housing units or additional square feet of office space—go up and with them the value of the land and what a developer can pay for land, assuming that the developer can receive higher sales prices and rents in such a location. A system of community benefits and affordable housing requirements will increase development costs and lower the price the developer can pay for the land. The landowner, in turn, will not be able to raise the price of the land as much as would be possible if the density were simply increased without any community benefit requirements. In the long run, the land market will adjust to the additional regulatory costs. Instead of a windfall to landowners, they get a lesser profit and the community shares some of the benefits.



Differences between Public Benefit Zoning and Other Value Capture Tools

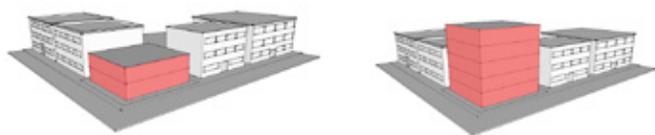
This paper focuses on Public Benefit Zoning, but there are additional mechanisms that capture development value, other than PBZ. There are at least five additional value capture mechanisms.

- 1) Incentive Zoning/Density Bonus
- 2) Housing Overlay Zoning
- 3) Tax Increment Financing
- 4) Community Benefits Agreement
- 5) Special Assessment Districts

Of these mechanisms, incentive zoning is the closest to PBZ, and the two are easily confused, but there are important differences. The major difference between PBZ and incentive zoning is that, generally, incentive zoning does not recapture land values but extracts community benefits from the additional density. It is reasonable to assume then, that when the incentive's value is slighter higher than the cost of the community facilities, the value of the land should not be affected. With the exception of Special Assessment Districts – that recapture some of the land value increases resulting from the building of infrastructure – and possibly incentive zoning, all the others capture value resulting from the development process, not necessarily land values.

Implementation of a Community Benefits Program

There are two implementation approaches to a Community Benefits Program: (1) Plan-based and (2) Negotiated.



1) Plan-based

With a plan-based approach, community benefits are tied to specific increases in the density of development (or land use changes) for a particular area. It is important that these benefits be established before the plan is adopted. The planning activities currently underway for the Priority Development Areas in the Bay Area represent an opportunity to adopt a plan-based Community Benefits requirement. One of the principal advantages of a plan-based approach is certainty for both the landowner/developer and the local jurisdiction.

2) Negotiated

Under a negotiated approach, land use changes and increases in density and community benefits are negotiated between the locality and the landowner/developer. These benefits are spelled out in a signed development agreement. The advantage of this approach is creativity. However, it takes more staff time and usually applies to larger developments.

For smaller tracts of land, both approaches might be too cumbersome. For these parcel sizes, a discretionary approval process that ties increased densities to a point system of benefits or a ministerial approach might be desirable.

Under any of these approaches, several steps are required. These include the following:

- How to determine the increase in land value resulting from plan changes/upzonings.
- How to determine which benefits to require, the “correct” level of benefits, and their potential impact on development financial feasibility.
- How to define options to provide benefits, such as paying fees or dedicating land.
- How to develop administrative procedures to operate a program.

Cities contemplating a Community Benefits Zoning strategy should conduct an economic feasibility study to determine how to structure zoning and development standards to allow community benefits requirements, while taking into account current and anticipated market conditions. EBHO's staff, members, and consultants can provide technical guidance when it comes to creating and implementing a Community Benefits Program.



Fox Courts: Successful outcome of affordable housing campaign: 80 affordable homes for very low-income families and people with special needs in Oakland developed by Resources for Community Development. Photos Courtesy PYATOK.

What Can Be Done When Market Conditions Make Public Benefits Zoning Unfeasible?

The value of urban land also changes based on the economic cycle. During the most recent cycle, (2008-2011) the value of real estate, particularly residential real estate, declined precipitously in some areas. Land values also declined during this period, as future development plans were put on hold. However, markets have rebounded, and development has revived in Bay Area locations located near job growth, such as Silicon Valley and San Francisco. However, not all submarkets in the San Francisco Bay Area can support higher densities due to market conditions. For those submarkets, options to consider include:

- (1) A jurisdiction can wait for the real estate market to pick up before adopting this strategy.
- (2) A jurisdiction can establish the community benefit levels at the time of plan changes or up-zoning, and wait for the market to improve. Then, these requirements can be phased in over an extended period of time.

Legal Aspects of Public Benefit Zoning

Under current state and federal constitutional law, if a city requires a fee or a dedication of land, it must establish through a nexus analysis that the condition's requirements (fees or land) are related and proportional to the impact of the development. If fees are required as part of PBZ, then a proportional nexus needs to be established. The community benefits gained through PBZ should be in addition to those obtained through existing Development Impact Fees, Inclusionary Zoning In-Lieu Fees, or Commercial Linkage Fees.

In most jurisdictions with Development Impact Fees, required fees are not set at the maximum that would be legally justifiable. PBZ fees, then, while "additional," can generally be set within the limits already established under the previous nexus analysis.

In the situation in which a city is already exacting Development Impact Fees that are close to the legal limits established through a nexus analysis, it would be necessary to make the case that higher density generates "additional" burdens making it necessary to require applicants to pay additional fees to mitigate projects impacts.

However, if PBZ requirements are established through development agreements, they may not require a nexus analysis.

Potential Community Benefits

There are many community benefits that can be funded through a land value recapture approach. Affordable housing is one of the most critical benefits, but others, such as public open space and public facilities, are also important.

Affordable Housing

One important approach to achieve public benefit zoning is to enhance a community's existing inclusionary housing program by requiring a higher percentage of inclusionary units than under the existing system. In jurisdictions that already have inclusionary housing policies in place, this new approach could redefine inclusionary housing as a two-tiered process. The first tier would impose inclusionary housing requirements within the existing zoning framework. Thus, if a developer does not receive additional density or a land use change, the existing inclusionary housing policy will apply. The second and higher tier(s) of inclusionary housing beyond the required baseline would be associated with substantive plan changes or up-zonings of either specific parcels or larger areas. This can be accomplished without significant additional costs to the developer and be consistent with the principle of land value recapture².

Similarly, Commercial Linkage Fees and Housing Impact Fees could be based on a two-tiered approach. The first tier would apply to existing zoning, and the second tier would be associated with plan changes/re-zonings. Since a majority of jurisdictions with commercial linkage fees and housing impact fees have adopted fees at levels lower than justified by nexus studies, this approach may not require new nexus studies.

Additional Community Benefits

New development generates a need for new facilities. To meet that need, developers pay development impact fees that are reasonably related to the impacts created by new development. Community benefits policies represent a creative opportunity to make sure that additional development and increased densities contribute to, not detract, from the community. This becomes imperative in the case of infill and densification. “No densities without amenities” could be the cry of neighborhoods impacted by densification and infill. A community benefits system could go a long way toward providing a portion of the necessary funding to pay for neighborhood improvements that would be in addition to the public benefits obtained through existing impact fee programs.

“
**NO
DENSITIES
WITHOUT
AMENITIES”**





Case Studies

This report covers the experiences of four California cities that adopted a Public Benefit Zoning program. The cities with the most experience so far with LVR are San Francisco and Santa Monica. These case studies are useful since they demonstrate successful approaches in implementing PBZ policies. What follows is a brief description of the PBZ programs in those two cities.

1) San Francisco: A Tiered Program of Combined Fees and Housing Options

As part of the preparation of a plan for the Eastern Neighborhoods the City established a “Tier” approach to baseline fees and public benefit fees, to reflect the relationship between higher densities and increased value for land and development.

Baseline impact fees are paid by projects that remain at current height (referred to as Tier 1), because there is no increment in value resulting directly from governmental action.

In existing mixed-use areas, a second and third tier of impact fees are triggered for sites where the Plan grants additional heights. Specifically, Tier 2 applies to an increase of one to two stories, and Tier 3 applies when three or more stories are permitted. The fees for Tiers 2 and 3 constitute baseline fees plus additional public benefit zoning fees.

To fulfill the goal of increased affordable housing production in the Eastern Neighborhoods, the Plan also requires that in areas rezoned from industrial to mixed uses (mostly residential), more affordable housing be produced than is required under the City’s inclusionary program. Within these zones, the Plan provides greater flexibility in the way affordable housing requirements can be met so that higher percentages of affordability are actually achievable. For example, if affordable units are provided on-site, a lower percentage of units need to be affordable. However, if these units are provided off-site, or if land is dedicated, or if affordable rents are targeted at middle incomes, then a higher percentage is required.

To help implement the Plan, the Eastern Neighborhoods Citizen’s Advisory Committee (EN CAC) was established by the City. The EN CAC provides input to City agencies and decision makers with regard to all activities related to the implementation of the Eastern Neighborhoods Area Plans.

Tier One

Establishes the base height & FAR

Tier Two

Allows additional height & FAR when community benefits are added

Tier Three

Even more height & FAR are allowed in exchange for higher levels of community benefits

2) Santa Monica: A Flexible, Tiered Approach

Santa Monica has a long-standing tradition of achieving community benefits through development agreements, including parks and park improvements, community health access, and child care centers with subsidies for low-income families. In 2010, after many years of extensive community engagement, the City adopted the Land Use and Circulation Element (LUCE). A fundamental tenet of the LUCE program was that future development should fund a range of measurable public benefits, from open spaces and parks to affordable housing.

As part of the LUCE preparation, preliminary economic studies were undertaken that analyzed the extent of enhanced land value resulting from higher densities. These analyses indicated that projects that would provide community benefits under LUCE were able to achieve financial feasibility.

LUCE established a community benefits tier structure for projects requesting an increase in the base height of 32 feet. There are three tiers.

- Tier 1 establishes the base height and FAR. No community benefits in addition to the existing ones are required, and the approval process is ministerial. Three to seven extra feet are allowed if affordable housing is provided on-site or close to transit corridors.

- Tier 2 allows additional height and FAR when community benefits are provided.
- With Tier 3 even more height and FAR are allowed in exchange for higher levels of community benefits. It is when developers seek Tier 3 density increases that development agreements are required. This process requires additional public review and flexibility and encourages high-quality projects. Tier 3 projects are larger in scale, and development agreements provide developers with a greater degree of entitlement certainty.

Given the high costs of development agreements, the City is now pursuing a ministerial approach as part of its zoning code update. When a developer chooses to exceed densities from Tier 1 up to Tier 2, he or she will be required to provide additional community benefits. The quantity (additional fees or affordable housing units) of these community benefits will be defined in 2014 as part of the Santa Monica Zoning Update, and presumably will be based on an updated nexus analysis.

Conclusions and Recommendations



FUNDAMENTAL RULE: DO NOT UPZONE WITHOUT TYING GREATER DENSITIES TO COMMUNITY BENEFITS INCLUDING AFFORDABLE HOUSING”

At a time when local governments search for ways to pay for needed improvements, services, and affordable housing, there is a valuable tool, Public Benefit Zoning (PBZ), available for many cities to consider. This White Paper describes this tool and provides examples of its use in cities in California. It works as follows:

When land is up-zoned or a plan updated to allow greater intensity of development, the value of the land generally increases. Most of this increase in value is the result of a public action and, for the most part, not due to actions undertaken by the landowner. When understood in this light, a strong argument can be made for the public to receive a reasonable share of the increased land value, to be used for community benefits. The technical planning term for this approach is “Land Value Recapture.”

What should localities do when contemplating Public Benefit Zoning (PBZ)? In short, localities should evaluate their market strength and analyze the value of the land before and after land use/zoning changes. Then it is up to the legislative body to decide how much of the “value enhancement” to recapture with community benefits. For more specific recommendations, see page 11.

In localities where the market is weak, usually places struggling to attract development, it is very tempting to upzone properties, with the hope that they will become more attractive to developers. While that is understandable, the upzoning would eliminate any possibility for community benefits when the market turns around. Downtown and Chinatown in Oakland are examples of areas where development interest is growing, but upzonings occurred prematurely.

This point warrants repeating: localities—all localities—should delay rezoning until Public Benefit Zoning policies are established. In weak markets, it could be possible to establish a “trigger mechanism” that phases in Public Benefit Zoning (see page 12).

Although PBZ is not as well known in this country as other mechanisms that harness market forces to

bring benefits to the public (incentive zoning, for example), it is the only one that explicitly attempts to recapture land value increases.

PBZ is based on the understanding that in large part the increases in land value are due to the growth of the region, public funded infrastructure and, more specifically, planning decisions—that is, public actions. Seen in this light it is only fair and equitable that landowners should share the benefits that the rest of us have bestowed upon them, by contributing to making the public city better. ❖



*Seven Directions, Oakland, EBALDC.
Photo courtesy PYATOK*



Emerald Vista, Dublin. Photo Courtesy Eden Housing

WHITE PAPER ON THE THEORY ECONOMICS AND PRACTICE OF PUBLIC BENEFIT ZONING

Background to Public Benefit Zoning

According to the Association of Bay Area Governments (ABAG) and the Metropolitan Transportation Commission (MTC), the San Francisco Bay Area will add more than two million people by 2040. To accommodate this growth while protecting our quality of life and our environment, ABAG and MTC have adopted a State-mandated Sustainable Communities Strategy—a regional land use and transportation plan called Plan Bay Area. It calls for most new residential development to take place in already built up areas close to public transit. These areas are called Priority Development Areas (PDAs). Part of this strategy is to produce vibrant “complete communities” near major transit stations or hubs with a mix of commercial, civic and residential uses. The challenge is how to ensure that these communities preserve and maintain a diverse mix of residents by income, age, disability, and racial and ethnic backgrounds over the long term.



**INCREASED LAND VALUES
CAN HAVE UNINTENDED
CONSEQUENCES HARMFUL TO
LOW-INCOME PEOPLE
LIVING OR WORKING IN THE
PRIORITY DEVELOPMENT AREAS”⁴**

This approach towards accommodating growth has the potential to make life better and healthier for all of us, but it also has the potential to lead to a significant increase in land values for real estate investors. As a result, it will not provide benefits to the wider community unless policies are adopted to mitigate unintended harm, such as displacement.

Compact growth—and the strategy to accommodate it—will increase land values in three ways:

- Regional and local policies and plans that focus new development in Priority Development Areas at the center of the region will make the land located in these areas more valuable.
- The region will invest billions of dollars in transportation improvements—with a significant portion going to mass transit in the central areas—thus increasing the value of properties benefitting from those investments. Economic studies have shown that when property is located near the Bay Area Rapid Transit System (BART), its value increases significantly.³
- Many local jurisdictions have or will change their land use plans to accommodate greater densities in the priority areas. Increases in allowable densities will further increase land values.
- Together, these three factors will increase land values substantially.



**IF GOVERNMENT ACTIONS
CREATE SUBSTANTIAL
INCREASES IN LAND VALUES
FOR PRIVATE INVESTORS,
THE COMMUNITY SHOULD
RECEIVE BENEFITS IN RETURN”**

These consequences include the following:

- High land costs make development of affordable housing more difficult. The non-profit housing developers who build housing affordable to low-income working people, seniors, and people with disabilities will have to pay more for land, thereby increasing the cost of development. Since subsidized rents are determined by median income (and not by the market), projects will become infeasible unless additional subsidy dollars are identified. For example, in 2010, San Francisco had to pay double the original value of the long-vacant Hugo Hotel, located in SOMA, to acquire it as a housing development site because the City had rezoned the area and increased the height limit on the site two years earlier.
- Expectations of future development opportunities at high densities could lead to speculation, where land is withdrawn from the market in expectation of even higher land values. The Hugo Hotel described above was held vacant by its owners for twenty-two years waiting for the most profitable time to sell. When supply is restricted by speculative holding of scarce resources like land, prices rise.
- Compact development in transit areas could encourage tearing down older low and medium density housing to allow construction of new, high-end market-rate housing at higher densities. This process eliminates relatively more affordable unsubsidized rentals for lower income people who rely on access to transit to commute to jobs.
- Development of new, high-end housing in the Priority Development Areas will make these areas more attractive to higher-income people. This is likely to raise rents in the existing housing nearby in communities without rent controls. Since a substantial part of the low-income population and communities of color of the Bay Area lives in these areas, these increases have the potential to displace the low-wage workers and communities who are actually the most likely to use mass transit services. Even in communities with rent control, over time, rents will rise to market levels because State law requires that vacated units be “decontrolled” for a new tenant. The result will be the exclusion of lower-income renters and less diverse communities.
- For those low-income working families who have been living in the Priority Development Areas, these market trends can result in displacement, higher housing and transportation costs, and longer commutes. In the long run, this has the potential to impact adversely the health and well-being of low-income and working families, and minimize any reduction in greenhouse gas emissions these policies were intended to achieve.
- There are solutions. We can have equitable compact development, if those who profit from public actions also provide public benefits. We need to recognize the following key points:
 - First, when government directs development to certain areas by changing land use plans to accommodate more density, or when government invests billions of dollars in transportation and other public services in these areas, they often become more attractive and rents and sales prices rise accordingly. One result is that there is an increase in land value. This increase in value is created by the public and not by the private investors who own the land. Since this increase in land value is due to public action and public investments, it represents “unearned” or “windfall” profits for the private investors who own the land.
 - Second, it is only fair and equitable for the public to receive a fair share of this unearned increase in land value in order to meet public needs and mitigate the harm that increasing land values cause to people who do not own real estate.

Requiring community benefits from landowners whose land has increased in value due to government actions is called “Land Value Recapture” (LVR). LVR is also known as Public Benefit Zoning (PBZ), Community Benefits Strategy (CBS), or Public Benefit Bonus (PBB).⁵ This approach has generated great interest in the Bay Area and, to a lesser extent, in the rest of the country in the past few years, stemming from several factors, most importantly the severe fiscal crisis of government at all levels.

This fiscal crisis is happening at a time when planning for smart growth and climate change is sorely needed. This planning will require that local governments support and provide incentives for private redevelopment and infill development in urbanized communities. The nature of denser development will require significant expenditures in improved and new mass transit systems and enhanced community amenities. These investments in public infrastructure and changes in land use regulations to allow greater densities will also create substantial, additional profits for many landowners, who are benefitting from changes they did not create. In this context it is not surprising that interest in land value recapture is rising rapidly.

A similar approach is already included in California State Law. For example, the State’s “density bonus” law allows residential developers the right to build at higher densities than are allowed by local ordinances in return for providing a percentage of the housing at below-market rents or sales prices.

What is important to understand is that with climate change, higher gasoline costs, lifestyle and demographic changes, and a host of other factors, we are witnessing a historic shift in land use and transportation planning. This shift is based on an increased awareness of the land-use/transportation connection, with public investments in transportation increasingly moving to non-automobile modes and land use patterns now emphasizing the creation of high-density, mixed use nodes and corridors served by mass transit and pedestrian and bicycle paths.

Economics of Land Valuation

Generally, the value of urban land is a function of the value of what can be built on it, and that, in turn, is related to its location. The more accessible a location the more desirable it becomes for development, making the underlying land more desirable as well - and more valuable. We should remind ourselves that it has been government investment in transportation infrastructure, from the land grants to railroad companies in the late nineteenth century, to the Federal Highway Act of 1956 to the BART system of the 1970s that improved accessibility, and enhanced the economic and social opportunities of this country. It also increased the value of land served by these networks and nodes of transportation infrastructure.

However, land values do not always increase over time, but can remain flat or decrease, in spite of public action. This is due to market conditions. Again the development of the BART system serves as a good illustration of how public action may not always increase real estate values. While the areas located near some BART stations have experienced higher rents and sales prices for housing, not all BART stations have. For example, a study conducted by a UC Berkeley researcher in 1996 found that one-bedroom apartments located within a quarter-mile of the Pleasant Hill BART Station rented for about 10% higher than comparable units located a little further from BART. However, these same trends were not noted in other Contra Costa County cities, such as Richmond and El Cerrito.⁶

The value of urban land also changes based on the economic cycle. During the most recent cycle, (2008-2011) the value of real estate, particularly residential real estate, declined precipitously in some areas. Land values also declined during this period, as future development plans were put on hold. However, markets behave cyclically, and have now rebounded and development has revived in Bay Area locations located near job growth, such as Silicon Valley and San Francisco. Once again, these areas are experiencing high home prices and rents.

Understanding how developers value land is a complex process that takes into consideration market factors (including risk), other real estate investments within a developer’s portfolio, and the cost and availability of interim financing.



FINANCIAL FEASIBILITY PROFIT & VALUE ENHANCEMENT

It is important to understand the impacts of public actions, such as rezoning and land use changes, on financial feasibility and value enhancement. There are a number of ways that the development community assesses financial feasibility, but profit is always expected. While developers will not define a maximum level of profit desired, they do define a minimal or threshold level of profit that is required to make a development project worthwhile. Required profit levels need to meet or exceed profit levels provided from other investments, taking into account the risk that accompanies real estate development and costs incurred prior to actual construction. Profit expectations are not static, and instead change over time to reflect overall economic conditions. To illustrate, profit expectations were lower during the great recession than during the boom period prior to 2007. If Land Value Recapture is adopted, then it is important that the level of benefits does not reduce profit such that development is no longer competitive with other investment opportunities which are less risky.

A complicating factor in estimating value enhancement is how land is valued by developers and landowners. If one investor owns the land and a second investor develops the project, then the value of the land could be negotiated between

the landowner and the developer. For example, if the costs of public benefits are added to project entitlements so that the developer has higher costs, the developer may offer a lower amount to the landowner. The landowner may accept a lower amount or decide to wait for a better offer, reducing the availability of land for development.

In order for the development to still yield a “normal” rate of return, the developer can try to charge higher prices (if demand is sufficient to support these prices), or can try to lower construction costs. If these strategies are not sufficient to make the project feasible and if landowners are resolute about their land prices, the developer may abandon the project.

The challenge to public agency staff is to determine the balance between the level of value enhancement, or the gain experienced by the landowner that stems from public actions, and the cost to the developer to provide the required public benefits. The ideal balance point is one at which the level of benefits will not reduce the land value below the point at which a reasonable landowner is interested in selling and which will still allow sufficient financial returns to the developer, while obtaining community benefits that will improve living conditions for current and future residents and businesses.

Land Value Enhancement and Land Value Recapture

LVR is easily understood as a two-step process - (A) Land Value Enhancement and (B) Land Value Recapture. These steps occur at the same time.

- A) Land Value Enhancement occurs when government increases the intensity/density of a particular land use, or changes the land use designation to a more profitable use—from agricultural or industrial to mixed-use, for example. The value of land can also increase when government builds infrastructure and public facilities including mass transit systems and freeway interchanges (which increase the accessibility of properties), or creates parks and other public facilities (which enhance the livability of an area).
- B) With Land Value Recapture, governments recapture part of the increase in land values through the planning process by requiring community benefits to be agreed upon in conjunction with the entitlement or planning process.

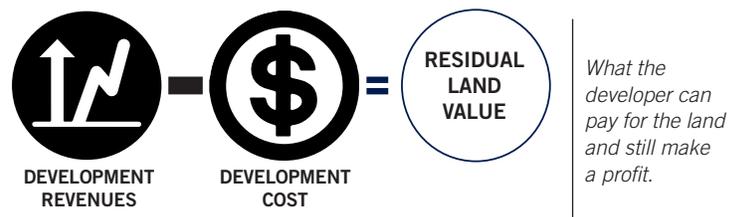


LAND VALUES AND THE COSTS AND BENEFITS OF REGULATION:
ALLOWING MORE DENSITY CAN INCREASE REVENUES FOR THE DEVELOPER INDUCING LAND OWNERS TO INCREASE THE PRICE OF THE LAND. MANDATING COMMUNITY BENEFITS INCREASES DEVELOPMENT COSTS FOR THE DEVELOPER, LOWERING WHAT SHE CAN PAY FOR THE LAND. SHE WILL BARGAIN FOR A LOWER LAND PRICE.”

As such, LVR is a two-part simultaneous process since the land value enhancement and land value recapture occur at the same time. However, not all land use changes and public facility improvements support an LVR policy. One way to assess when LVR is financially possible is through a “Residual Land Value Analysis.”

With this analysis, total development costs and revenues of a project are established and costs are subtracted from the revenues. A positive figure indicates what the developer can pay for the land and still make a profit. A negative figure indicates that there is no market for the proposed development, since the revenues from selling or renting space are inadequate to provide both a return and cover all development costs.⁷

- **Costs:** While construction costs and the cost of construction financing will probably be very similar within the same region, there might be great variation in terms of governmental fees, such as permits and processing fees, park fees, commercial linkage fees, etc. Construction costs will also vary depending on the type of construction used.
- **Revenues:** In a residual land value analysis, revenues are calculated differently for ownership and rental developments. For ownership projects, the revenues are defined as the sales prices summed over all units less the sales expenses. In the case of rentals, the revenues are defined as the capitalized value of net operating income over a specified holding period, generally 20 or 30 years.⁸ These revenues will vary according to the strength of demand for rental housing in a given area over time.



It is also important for localities to pay close attention to how increases in density and height can increase development costs by requiring a change from less expensive to more expensive construction types. For example, an up-zoning that allows greater residential building heights may require use of much more costly materials (such as reinforced concrete or steel construction) than for a lower building which uses wood-frame construction. In order for land values to increase, it is necessary for the local government to provide a sufficiently large enough additional height allowance to make the project profitable, given the higher construction costs of structures in excess of five stories. This can only happen when housing demand is sufficiently strong that prices justify more expensive per unit construction costs.

For an example of Residual Land Value Analysis that compares land values under current and proposed zoning, see Table 3 on page 26. Through application of a residual land value analysis, it is possible for a jurisdiction to estimate the actual value enhancement associated with its public actions. This increase in value can be used to help a jurisdiction determine the level of required community benefits from a new development, while at the same time maintaining the development’s financial feasibility.

Differences between Public Benefit Zoning and Other Value Capture Tools

The term “Value Capture” is being utilized with increasing frequency in the planning and redevelopment fields. As the term implies, it refers to various mechanisms that extract some value from the development process. This paper focuses on Public Benefit Zoning, but there are additional mechanisms that capture development value, other than PBZ. In fact, Public Benefit Zoning (technically referred to as Land Value Recapture) is the latest entry in what was defined in 1992 as one of the newest developments in United States land use policies, i.e., “the movement from command-and-control to market-based regulatory strategies.” (Kayden, 1992: 565). Based on the recognition that land use regulations, “confer as well take away property rights, landowners now would be encouraged, rather than commanded, to provide or preserve desired public amenities in their private developments through the powerful force of financial self-interest. Public and private interests would join forces for the common good.” (Kayden, 1992: 568).

There are at least five additional value capture mechanisms.

- 1) Incentive Zoning/Density Bonus
- 2) Housing Overlay Zoning
- 3) Tax Increment Financing
- 4) Community Benefits Agreement
- 5) Special Assessment Districts

Incentive Zoning/Density Bonus

Incentive Zoning, also known as “Density Bonus,” is very similar to PBZ but with a fundamental difference. It is similar because it grants developers the right to build additional space in exchange for providing community amenities. This will work if the developer calculates that the value of the incentive provided is greater than the cost of providing the amenity. It is, therefore, voluntary. In addition to higher densities, other incentives commonly include reduced parking or modifications to height and setback requirements. It is different because it does not, generally, recapture increases in land value for public benefits.

California State Law mandates that density bonuses be granted for affordable housing, senior housing (whether or not affordable), donations of land for affordable housing, condominium conversions that include affordable housing, and child care facilities. In addition to density bonuses, applicants who provide affordable housing qualify for zoning concessions and for reduced parking standards. The great majority of California cities have shaped these “density bonus” regulations to reflect their unique settings and circumstances. However, thus far, the effectiveness of the density bonus law in producing affordable or senior housing has not been systematically studied.

While this law has the potential to produce affordable housing, it must be observed that it has also the potential, if applied on a large scale, to interfere with local planning processes. Which parcels are developed with higher densities (that can be as high as a 35 percent increase over existing zoning) is not based on a land use plan. The advantage of a land use plan is that it is generally prepared with citizen participation and is presumably based on the capacity of public infrastructure and public facilities to handle more intensive development. Instead, the granting of a density bonus is an ad hoc process based on developers’ decisions. These decisions depend on the characteristics of the market and area at a particular time. Thus, while California’s Density Bonus Law has the potential to produce affordable housing units, it has the drawback of doing so at the expense of the planning process. Ironically, the more units that are produced under a Density Bonus policy, the greater the likelihood of interfering with adopted land use plans.

In addition to state bonus law, incentive zoning is utilized extensively in California, as well as elsewhere in the country to encourage private developers to provide increased public amenities through increased densities. Incentive zoning began in Chicago in the late 1950’s, was adopted in New York City in 1961 to encourage plazas and arcades, and adopted in San Francisco in 1968. In San Francisco, density bonuses were made available to developers in the financial district if they provided any of ten amenities. The choice and type of bonuses were related



INCENTIVE ZONING DOES NOT, GENERALLY, RECAPTURE INCREASES IN LAND VALUE FOR PUBLIC BENEFIT”

to the characteristics of the zoning proposals. There were problems with the implementation of the San Francisco program. Following the approval of San Francisco's Downtown Plan in 1984, the bonus system was eliminated, and mandatory requirements were established.

Most cities in the US, regardless of size, have a provision in their general plans or zoning codes for incentive zoning. For example, the General Plan for the City of Walnut Creek a medium-sized city in California, states the following: "Allow increases in height for developments that provide exceptional public amenities such as accessible roof gardens, ground level public plazas, creek orientation, public courtyards and passage ways, landscaping, public art, and other desired amenities specified during the normal City Review process" (City of Walnut Creek 2006, p. 4-13.3.2).

The first step in establishing an incentive zoning program is to establish the base density, usually calculated as a floor area ratio (FAR) or units/acre. If the base zoning is set too high, developers will not need the bonus. Therefore, it is important to reduce the existing base zoning in many cases (Kelly and Rohen, 2013). Downzoning, however, may be highly controversial with property owners. Next, the amenities need to be identified and prioritized. The amount of the bonus available for providing amenities is calculated. Finally, the award of bonuses is arrived at either by-right or determined through negotiations. A number of cities have employed the by-right approach for minor projects and used a discretionary process for larger ones.

An important example of an incentive zoning program was established in downtown San Diego in 2006. It allowed developers to receive increases in FARs if they provided benefits that could include any of the following: Affordable Housing, Urban Open Space, Three Bedroom Units, Eco-roofs and Employment Uses. The FAR increases are established on the basis of either the percent or quantity increases of the amenities. The value of both is established through economic analysis. According to a Civic San Diego document, the bonus programs "have been attractive to developers and have been successful in increasing densities and have resulted in the provision of public amenities and benefits" (Civic San Diego, 2012, p. 2). Incentive zoning then, benefits the City and the developer, since the value of the bonus is intended to exceed (slightly) the cost to the developer of providing the public benefit. The landowner also benefits because the price of the land should be unaffected, unless the land is downzoned as part of the incentive zoning program.

In sum, both the state density bonus law and incentive zoning are voluntary for the developer. Under state density bonus law the public benefit includes affordable housing, but the process is ad hoc with regards to planning principles. In the second case (incentive zoning) the benefits to the public are multiple, but affordable housing is not assured. Depending on the cost of the benefit to be provided, developers can choose from a variety of options. The difficulty for the public agency lies in establishing the right "price" for the benefits. As Kayden points out - "The 'price' is too low when the city could have obtained more amenities for the same incentive or dispensed less incentive for the same amenity" (Kayden, 1992, p. 570).

Housing Overlay Zoning

An Overlay Zone is a local planning tool that provides a set of incentives or requirements that apply to an entire area in addition to the underlying or base zoning requirements. Overlay zones give cities flexibility that doesn't exist in the basic zoning requirements themselves. Overlay zones are often used for historic districts, natural resource protection, and other community goals. Housing Overlay Zones focus specifically on affordable housing, and can be used to establish mandatory requirements for inclusion of affordable housing or, similarly to California Density Bonus Law, can provide incentives to encourage production of affordable housing. However, a Housing Overlay Zone is a local tool and not restricted to what state law prescribes. It can provide, for example, more incentives for greater housing affordability. It can allow housing in commercial or industrial districts. Most importantly, its features are established through a process that ensures political buy-in and political support. Such support will be generated when the community feels that: (1) The overlay zoning will not overcome the capacity of the existing infrastructure and public facilities and, (2) They can exert some control of the design and the aesthetic quality of what is built in the district. In comparison to State Density Bonus Law, Housing Overlay Zones are established as part of a planning process. They are an excellent approach that encourages production of affordable housing while maintaining local control on land use.

Tax Increment Financing

With Tax Increment Financing (TIF) the increment in property tax resulting from an increase in property value is captured to support further redevelopment. It would be erroneous to classify TIF as a land value recapture mechanism. Under the standard redevelopment/TIF scenario, the value of land increases as a result of public financing of infrastructure and subsidies to developers that lead to new private development and increases in the overall attractiveness of the area. Landowners reap windfall profits in those instances when redevelopment is highly successful. In other words, TIF is set up to work as a land value granting tool and not a mechanism to recapture land values from landowners.

Tax increment financing is still used in other states, but is no longer widely used in California. While TIF benefitted both property owners and local governments, it resulted in a decrease of property tax revenues to the other taxing entities, which in turn put pressure on the State budget. Because of California's budget problems during the Great Recession, Governor Brown dissolved the redevelopment agencies that had used TIF to upgrade areas.

Community Benefits Agreements

A Community Benefits Agreement (CBA) is a private agreement between a developer and a community coalition. The community benefits are usually obtained in exchange for political support by the coalition of a major project. The benefits are usually jobs and housing, but other benefits are possible. In order for the CBA to work, the community must have enough political pull to possibly block the project. CBAs are problematic to implement for various reasons. Most importantly, it is difficult to create, inform, and manage the complex, multi-interest coalitions necessary to negotiate successfully with the developer to bring about major benefits. What makes CBAs rather unusual in the urban development arena is that they exclude, in most cases, government. They extract community benefits from the development process, but outside the planning/regulatory framework of the public sector. When CBAs are attempted, the developer is most likely already the landowner, and the benefits will be a cost to the developer, not the landowner. Nevertheless, CBAs are a great way to lessen the impacts of major development projects in lower-income communities.

Special Assessment Districts

Special Assessment Districts have been around, in various incarnations, since the middle of the 19th century. With it, property owners who benefit from a particular infrastructure improvement -from sidewalks to parks to mass transit stations - are required to pay an amount proportional to the benefit resulting from the public work(s) that is financed. Special Assessments Districts are indeed a land value capture mechanism, such as PBZ, but are different in that they extract land value increases resulting from infrastructure and public facilities construction, and not land use changes (as emphasized in this White Paper).

Assessment Districts were used extensively in the early twentieth century and "financed much of the public infrastructure to support urban and suburban development in California and the rest of the country during the nineteen and early twentieth century up to the Great Depression of the 1930s" (Misczynski, 2012, p. 98). Their use declined during the depression and in the post-World War II period. After Proposition 13 was passed in 1978, the use of special assessment districts increased considerably, leading to endless debates about their nature (assessment vs. tax?), several court cases and legislative attempts to both curtail and expand their use, and the passage of the more flexible Mello-Roos Legislation (allowing the costs to be passed onto future homeowners). Finally the passage of Proposition 218 in 1996 raised new requirements, including placing the burden of proof on government to demonstrate that assessments need to be proportional to the special benefits received.

Mass transit, and especially mass transit stations, is one of the numerous public works that special assessments can help finance (Mathur, 2014). Given the importance assigned to the development of Transit Oriented Development in ABAG's Sustainable Communities Strategy, and the need to pay for infrastructure, public facilities and affordable housing in TODs, the use of special assessment districts around transit stations and corridors needs to be employed whenever possible. In California, the California Public Utilities Code, secs 33000 et seq. allows the authority to create assessment districts around stations and rail lines.

Probably the most important example of its application is the assessment districts in Los Angeles created in 1985 by the LA County Metropolitan Transportation Authority in downtown and the McArthur Park/Westlake area. It was designed to raise \$130 million to pay for nine percent of the cost of the first segment of the Los Angeles Red Line. Although successful, this was not replicated. Misczynski

(cited above) reflects that the lack of replication “may partly reflect the apparent increase in virulence in political opposition to asking anyone to pay anything for public projects.” But the attempts at regional planning to produce vibrant “complete communities” near major transit stations – to help implement AB 32 and SB 375 - and other political changes that have occurred in the past few years in California, bode well for a renewed use of special assessments to help finance transit and redevelopment near transit.

Discussion

This section provides a brief overview of the major value capture mechanisms in California. With the exception of Special Assessment Districts – that recapture some of the land value increases resulting from the building of infrastructure – and possibly incentive zoning, all the others capture value resulting from the development process, not necessarily land values. Incentive zoning is the closest to PBZ, and the two could be easily confused, but there are important differences.

First, when superimposed in an ad-hoc fashion on an existing planning framework incentive zoning can undermine existing regulations, lower the level of services provided by public infrastructure and public facilities and frustrate citizen participation processes (Bucknall 1988; Calavita & Mallach 2009). Second, when applied without adequate economic analysis and policies, it can lead to various inefficiency and fairness problems as was the case in the past in cities such as New York, San Francisco and Santa Monica, to name a few (Kelly 2013).

Third, when the costs to the developer of required community benefits are low compared to expected incentive zoning benefits it can lead to higher land prices. For example, in New York in the 1970s and 1980s, the “anticipation of bonus fed into higher land prices” (Cullingworth and Roger Caves (2003: 118).

Thus, it is probable that incentive zoning does not recapture land values but extracts community benefits from the additional density. It is reasonable then to assume that when the incentive’s value is slightly higher than the cost of the community facilities, the value of the land should not be affected. Additional research would be helpful in establishing under what circumstances a density bonus might be utilized to recapture land values. One way could be to lower the existing base-zoning.

Recapturing land values through public benefit zoning is worth pursuing for two important reasons. First, it can generate more public benefits than incentive zoning. Second, the land value recaptured for public benefits originates from all us -- from the growth of the city, the public goods provided by government, the investment in productive business and public planning and controls. It is only fair that some of the increases in land value be dedicated to the building of the public city.

How to Assess the Market Potential for Public Benefit Zoning

What are the prospects of Public Benefit Zoning (PBZ) in the Bay Area at this particular time? To succeed, PBZ works best in a strong, or at least stable, real estate market, making it difficult to implement in many outlying localities. In the central San Francisco Bay Area Region, there are many localities experiencing economic growth and, with it, demand for housing and commercial development. That demand, as we have seen, will be met for the most part in PDAs. It is in these places, then, that PBZ could be applied.

Another necessary condition for the successful application of PBZ is that properties in the PDAs have not yet been up-zoned. While land values in PDAs might increase on the basis of the expectation that densities will be allowed to increase, it is at the time of plan change or up-zoning that those values are solidified.



**PUBLIC BENEFIT ZONING
CAN WORK IN STRONG,
OR AT LEAST STABLE,
REAL ESTATE MARKETS”**

With up-zoning the possible revenues—due to the construction of additional housing units or additional square feet of office space - go up and with them the value of the land and what a developer can pay for it. A system of land value recapture in the form of community benefits and affordable housing will increase development costs and reduce the price the developer can pay for the land, but the higher density of development will still result in reduced, per-unit land costs. If the landowner wants to sell, then he or she will not be able to raise the price of the land as much as would be possible if the density were simply increased without any requirements. While the landowner will not receive the maximum price possible without PBZ, there will still be a sizeable profit (but not as great a

windfall profit) due to the public actions of plan changes/up-zoning and transportation improvements. Economists generally agree that, in the long run, the land market will adjust to the additional regulatory costs. In other words, these regulatory costs are likely to be borne by landowners, since developers will need to take into account the cost of affordable housing and community benefits when deciding how much to pay for land.

Theoretically, none of this will cost developers more money as long as the requirements are part of the rezoning process or are stipulated when land-use plans are changed. In this way, developers know in advance what the costs are and take them into account when they buy the land. Thus, timing of the implementation of PBZ policies is very important. If there is significant value enhancement, landowners will not be appreciably impacted because the price of the land still goes up, just not as much as it would have if the land had not been subject to public benefit requirements.

Approaches to the Implementation of Public Benefit Zoning

There are two typical implementation approaches to Public Benefit Zoning: **(1) Plan-based and (2) Negotiated.**

1) With a plan-based approach, community benefits are tied to specific increases in the intensity of development (or land use changes) for a particular plan area. It is important that these benefits be specified prior to the adoption of the plan. The specific planning processes associated with Priority Development Areas in the nine Bay Area Counties represent an opportunity to adopt plan-based PBZ. In the last few years, the Metropolitan Transportation Commission (MTC) has recognized the importance of planning for these priority areas and has provided funding to local governments to prepare specific plans that establish the framework for higher densities and mixed-use development. Included in this work is the identification of needed improvements to the existing infrastructure and facilities in order to facilitate more intense development in the PDAs. These public improvements would also benefit current residents and businesses in the area by improving neighborhood conditions. At the time of plan adoption or plan change, it is possible to tie community benefits to specific increases in the intensity of development

or land use changes. One of the principal advantages of a plan-based approach is certainty for both the landowner/developer and the local jurisdiction. This is also an open process.

As noted earlier, there are two kinds of PDAs—planned and potential. In the planned areas, the planning has already been done. Potential PDAs are still in the planning stage. However, many planned PDAs are planning for a level of development that is not necessarily feasible right away—especially in the “communities of concern.”⁹ Land values have not risen to their maximum potential yet, and are waiting for demand and housing prices to increase further, which means there is still opportunity for PBZ.

A good example of a plan-based approach is that of San Francisco which is based on a tiered fee structure (see page 23). Projects that conform to current zoning (and which do not receive additional height allowances) pay baseline benefits that all developers are required to pay. This is referred to as Tier One. For projects that receive additional height allowances, additional benefits are required by the City. These are referred to as Tier Two and Tier Three benefits, depending on the number of additional stories allowed.

2) Under a negotiated approach, land use changes and increases in density and community benefits are negotiated between the locality and the landowner/developer. These benefits ultimately are specified in a signed development agreement. The advantage of this approach is creativity. For example, benefits to be provided can be tailored to the specific project characteristics. However, there is also some uncertainty about the end result. This approach is more staff-intensive and less transparent and usually applied to large/intense developments. A good example of this is the City of Santa Monica (see page 19). Considerable consultant and staff time is required using a negotiated approach to determine the added value conferred by the up-zoning and to work out the types and levels of community benefits with the affected community.

For smaller tracts of land and when the enhanced value is minor, development agreements might be too cumbersome. An adjudicative discretionary approval such as a conditional use permit process that would tie increased densities to a point system might be desirable. Santa Monica is working now on this and other approaches – including a ministerial entitlement based on compliance determination - as an alternative to development agreements.



CAUTIONARY NOTE:

REGARDLESS OF THE APPROACH CHOSEN TO IMPLEMENT PBZ, LOCALITIES SHOULD ALWAYS KNOW WHAT IS FINANCIALLY AT STAKE AND NEVER ENGAGE IN NEGOTIATIONS OR PREPARE PLANS WITHOUT KNOWING THE COSTS AND BENEFITS OF DEVELOPMENT. MOST IMPORTANTLY, ONCE UPZONINGS HAVE BEEN GRANTED OR LAND USE PLANS CHANGED, THE OPPORTUNITY FOR PBZ DISAPPEARS AND SO DOES THE OPPORTUNITY TO RECAPTURE SOME OF THE INCREASES IN LAND VALUE FOR THE BUILDING OF THE PUBLIC CITY.”

The Public Benefit Zoning Implementation Process

In order to implement a PBZ program, several steps are required. These include the following:

- How to determine the increase in land value resulting from plan changes/upzonings.
- How to determine which benefits to require, the “correct” level of benefits, and their potential impact on development financial feasibility.
- How to define options to provide benefits, such as paying fees or dedicating land.
- How to develop administrative procedures to operate a program.

1) Determine Additional Value Created by Plan Changes/Up-zoning

The best way to determine the additional value to land associated with plan changes and up-zoning is the comparison of residual land value analyses of development under existing land use regulations and under proposed land uses/densities. The difference between the existing land value and that resulting from zoning and land uses changes defines value enhancement.

The San Francisco case study on page 19 includes an example of a residual land value analysis that compares current with proposed zoning that was undertaken to assess the viability of PBZ in San Francisco.

2) Determine Which Benefits to Require and Impacts on Financial Feasibility

Community benefits under a PBZ policy are unique because they can reflect community preferences. In comparison, infrastructure and facilities funded by development impact fees are generally defined by public agency staff working in conjunction with public officials and stakeholders. Through community meetings of current residents and businesses, it is possible to develop a list of benefits that are preferred and which can be included in a PBZ program.

Examples of community benefits include affordable housing, open space and parks, child-care facilities, streetscape and pedestrian amenities, and transportation alternatives to the automobile. In San Francisco, all community needs were calculated on the basis of public facilities standards and extensive meetings with the community. Additional benefits could include provision of larger size housing units (e.g., requiring units with three or more bedrooms), funding for local schools, green development, and economic development opportunities. All of these benefits would be in addition to requirements already placed on new development, such as development impact fees, commercial linkage fees, and inclusionary housing requirements. (For a more extensive discussion of Community/Public Benefits see page 15.)

The costs to provide public benefits in a targeted area can be estimated in a fashion similar to estimating costs for a capital improvement plan. First, costs for all improvements are determined. Then, a portion of these costs can be levied on individual projects. The appropriate fee level will, in part, depend on potential financial impacts of the fees (or other options in lieu of paying fees) on development financial feasibility. If the fee is too high, it could lead to a decision not to build or to change the nature of the project. If the developer decides to change the project – for example building luxury condos instead of rentals - it is possible that additional financial analyses will be necessary. The “appropriate” (from a financial standpoint) level of public benefits would be as high as possible while maintaining the financial feasibility of the proposed project.¹⁰

3) Options to Paying Fees

In many cases, landowners/developers prefer to pay fees, since fees provide certainty about the actual costs of complying with a PBZ Program. However, in some cases, it may be more economically advantageous for landowners/developers to meet their obligations through other mechanisms. It is not possible to identify all the creative approaches possible, but two are presented below: Land dedication and partnering (with local government and/or non-profits).

Land Dedication

In focused growth areas where land prices are likely to increase as development is promoted, affordable housing can be constrained by the high cost of sites. Thus proactively acquiring land to be set aside for affordable housing development will both control costs and ensure a mix of market-rate and affordable housing in these infill areas as they are developed. PBZ can be structured to encourage dedication of privately-held sites by developers in exchange for added value on other development sites through re-zoning and other public actions. In addition, land banking can also be a way to provide land for open space.

Partnering

Another way that a landowner/developer can provide community benefits, for example in the provision of affordable housing, would be to partner with an affordable housing provider. The landowner/developer provides the land to a nonprofit developer, and in turn, the developer secures affordable housing financing.

4) Administrative Procedures

When a jurisdiction adopts a PBZ program, it is necessary to establish administrative procedures to implement the program. These procedures will need to be defined to cover the type(s) of programs to be adopted by a jurisdiction, be it plan based (specific language is adopted in the specific plan or zoning code), adjudicative (if a conditional use permit process is adopted) or legislative (based on a development agreement approach). The principal trade-off in establishing the type of program to be adopted is costs (plan-based approaches are more economical, since less staff time is required) versus flexibility (adjudicative process or developer agreements allow more negotiation, but require more staff and consultant time).

Furthermore, the program must be administered on an ongoing basis after development is completed. Monitoring compliance and assessing results are very important. If funds are collected, but not spent on community benefits in a timely fashion, the residents and businesses that collaborated with the jurisdiction may get discouraged and be less supportive of future civic engagement. A program may sound good on paper, but can only succeed if it is effectively administered. Finally, as is true with any regulatory program, an appeals process needs to be established.

What Can Be Done When Market Conditions Make Public Benefit Zoning Unfeasible?

As mentioned above, not all submarkets in the San Francisco Bay Area (1) Have recovered market strength or (2) Experience market demand for high density housing. For those submarkets, there are several options to consider:

- (1) First, it is always possible to wait for the real estate market to pick up before adopting PBZ. However, by the time the market has recovered, land prices may already have increased, reflecting greater market demand. In other words, it could be too late to establish a financially feasible public benefits program.
- (2) Alternatively, a jurisdiction can establish the community benefit levels at the time of plan changes or up-zoning, and wait for the market to improve. Then, when new development becomes feasible these benefits will be required. Through the use of a residual land value analysis, it is possible to define a trigger point or trigger points when community benefits are to be provided.¹¹ The advantage of this approach is to provide certainty to the developer, landowner, and the community as to when the recapture associated with an up-zoning will be implemented. One of the limitations of this approach is that if the actual dollar amount of the benefits is determined much earlier than when landowners/developers will need to pay for them, the revenues to be received may not cover the full benefit costs due to incorrect estimates of inflation, rising construction costs, or other factors.
- (3) Adopt the requirements, but phase them in over an extended period of time. This approach has the advantage of encouraging early development before new requirements kick in, and if successful, that development in turn could start to stimulate additional projects at a level that supports PBZ.

- (4) Allow landowners/developers a choice between paying the exactions up front or over a reasonable period during which time the market is likely to improve.
- (5) In large developments, phase-in the provision of community benefits. New master planned developments require considerable investment initially and may require several years before profits are realized. If benefits are phased in as development stages are completed, it can be a win-win situation for both the community and the developer. The developer will have greater cash flow to assist in paying for benefits, and therefore, the community can request a higher level of benefits. It is important to understand that realization of both the increases in land value and the community benefits will come later, when enough development to fund the community benefits actually occurs.

Legal Aspects of Public Benefit Zoning

With PBZ, community benefits are gained by a locality in exchange for upzonings and plan changes that increase the value of the land. Is it legal? The answer depends on the type of community benefits and how they are required.

Under current state and federal constitutional law, if the requirement is a fee or a dedication of land (including an easement granting a right of access) and is imposed on an ad hoc basis during negotiations over development approval, a proportional nexus to the impact of the development must be established. And, under California’s Mitigation Fee Act, a development impact fee even if generally required for all developments by local law (such as a development impact fee ordinance) also requires the community to establish a proportional nexus. But if the requirement is something else—like Inclusionary Housing or a childcare facility—the relationship shown may only need to be a simple, reasonable relationship between the requirement and the purpose of the requirement. The application of this reasonable relationship test to Inclusionary Housing, however, is currently under review by the State of California Supreme Court in the *California Building Industry Association v. City of San Jose* case.

The courts consider a fee or dedication required as part of the negotiation of the approval of an individual development as having great potential for inappropriate leveraging of conditions by local government. Requiring the proportional nexus guards against this in the view of the courts. Conditions imposed as part of local legislation that apply equally to all developers do not carry the same potential for abuse because they are enacted through the local legislative public process. However, any condition that is imposed legislatively for the purpose of mitigating a development impact must have a nexus to the impact. Consequently, the proportional nexus requirement may apply to a fee or other requirements imposed to mitigate an impact of the development.

If fees are required as part of PBZ—as is the situation for the Eastern Neighborhoods PBZ in San Francisco—then a proportional nexus needs to be established. But, as stated before in this White Paper, the community benefits gained through PBZ should be in addition to those obtained through existing Development Impact Fees, Inclusionary Zoning In-Lieu Fees, or Commercial Linkage Fees. It might be difficult, however, to establish a nexus between additional density and higher fee requirements. But such an analysis would not be necessary in most cases because in most jurisdictions, Development Impact Fee requirements are not set at the maximum that would be legally justifiable. PBZ fees, then, while “additional,” can generally be set within the limits already established under the nexus analysis as the following section explains.

1) Development Impact Fees, Commercial and Residential Linkage Fees, Nexus Analyses and Public Benefit Zoning

Development Impact Fees (DIFs) are fees paid by developers to offset the infrastructure and public facilities needs generated by new development. Rare are the localities that charge Development Impact Fees at levels that would mitigate all the costs of growth associated with new projects. In fact, many cities—generally those not experiencing high rates of growth or located in rural areas—do not charge fees at all. Where imposed, impact fees usually represent a fraction of what is legally justifiable. This underpaying is related to the fear that imposing the full costs of growth would discourage development and, in some localities, the political strength of developers in the local decision making process.

This is also true in the case of Commercial Linkage Fees. In the majority of cities with these fees, the fee level chosen by decision makers is usually much lower than what would be legally justifiable, as determined through an analysis of the nexus between lower paying jobs generated by commercial development and the need for affordable housing. Similarly, as many cities have recently chosen to conduct residential nexus analyses to justify fees charged in-lieu of provision of inclusionary housing, it is also true that the housing mitigation fees are generally set at levels lower than would be legally justifiable.

The Eastern Neighborhoods case study in San Francisco (see page 19) is a good example of a city that prepared a nexus study. San Francisco conducted a Citywide Housing Nexus study in 2006. This Study set the upper limits of what can be required through an inclusionary program. San Francisco also prepared a standard-based/quantitative analysis and conducted community meetings to assess the need for community facilities. Based on those studies, the City took the following steps:

- Determined the highest fee level possible.
- Conducted market analyses which concluded that charging those fees would discourage development.
- Determined basic fee levels that were below the maximum allowable and which did not interfere with financial feasibility of new projects.
- Established additional fees, beyond the basic level, but still within the maximum justifiable amount. These additional fees are charged on developments that exceed the basic tier system. Thus, developments that apply for additional height pay additional fees, without requiring the City to conduct a new nexus study.

This approach assumes that the higher level of fees associated with PBZ (which add to development costs) would be offset by a lower land price. Since developers would need to pay the fees, they would not offer as high a price for the land. Therefore, the landowners would receive a lower price for the land than they would otherwise, given higher allowable densities. This process offsets the costs of paying higher fees, while at the same time, it is not likely to discourage development.

In the situation in which a city is already exacting Development Impact Fees that are close to the legal limits established through a nexus analysis, it would be necessary to make the case that higher density generates “additional” burdens making it necessary to require

applicants to pay additional fees to mitigate projects impacts. This is possibly the case in Santa Monica where, when a developer chooses to exceed densities from Tier 1 up to Tier 2, he or she will be required to provide additional community benefits in the following categories: Affordable and Workforce Housing, Trip Reduction and Traffic Management, Community Physical Improvements, and Social and Cultural Facilities. The quantity (additional fees or affordable housing units) of these community benefits will be defined in 2014 as part of the Santa Monica Zoning Update, and presumably will be based on an updated nexus analysis.

As mentioned above, however, localities that charge close to full development costs as Santa Monica does are extremely rare, and the approach taken by San Francisco in the Eastern Neighborhoods would be appropriate in the great majority of cases.



WITH PBZ COMMUNITY BENEFITS ARE USUALLY IN ADDITION TO DEVELOPMENT IMPACT FEES AND CAN GENERALLY BE SET WITHIN THE LIMITS ALREADY ESTABLISHED UNDER THE PROPORTIONAL NEXUS ANALYSIS OF THE 1) IMPACT OF A DEVELOPMENT AND 2) REQUIREMENTS SUCH AS FEES.”

2) Development Agreements

Development agreements are a contract between a locality and a developer. Based on negotiation and bargaining, they provide certainty and flexibility for both. The problem is that they can be quite expensive for the city (and the developer), both in terms of time and resources. From a PBZ process perspective, the possible benefits are substantial. If conducted correctly on the basis of economic analyses agreed upon by both parties, they have the potential to generate the highest level of community benefits economically possible. In Vancouver, where a negotiation-based approach has been in place for quite sometime, apparently the City is able to recapture approximately 80 percent of what in Vancouver is called the “lift,” or the increase in land value resulting from upzonings.

Santa Monica (see page 28) has used and will continue to use development agreements for larger projects (Tier 3). One of the problems usually associated with development



Jack Capon Villa, Alameda, SAHA/HCEB. Photo Courtesy Keith Baker photography.

agreements is that they can limit transparency and accountability. Santa Monica, however, has demonstrated that these problems can be easily overcome with an open process and intensive citizen participation and involvement. Most importantly, with this approach, PBZ is perfectly legal and, from an Inclusionary Housing perspective, rental inclusionary units can be part of a development agreement. This is important because with the Palmer case the court declared rental inclusionary units illegal. However, if the development agreement requirements entail fees or provision of public facilities, required benefit levels would need to be justified by a nexus study.

Potential Community Benefits

There are many community benefits that can be funded through land value recapture. Affordable housing is one of the most critical benefits, but others, such as public open space and public facilities, are also important.

1) Affordable Housing

These are hard times for affordable housing in California. Increasing numbers of California's residents face greater poverty, instability, and homelessness, yet there are fewer resources to provide affordable housing. We are experiencing a period of time in which wages/incomes are stagnating while housing prices have continued to rise in many market areas. The demise of redevelopment agencies in February 2012 eliminated what was probably the largest and most consistent local source of funding for affordable housing.¹² Combined with the depletion of hundreds of millions of dollars in voter approved bonds of affordable housing development funding from Proposition 1 C (passed in 2006 and already expended) and major cuts to federal funding programs such as the Section 202 Program for seniors and reductions in the Housing Voucher Program, we have lost billions for affordable housing construction and preservation annually in California.



Harrison Street Senior Homes, Oakland, Christian Church Homes and Oakland Housing Authority. Photo Courtesy PYATOK.

But the crisis is much more than a loss of financing. Over the years an extensive network of nonprofit affordable housing developers has evolved that has become increasingly sophisticated in the intricate and demanding affordable housing development process. With the loss of financing, this network will be weakened, losing irreplaceable expertise that has taken decades to build. Also, an interruption or reduction in the development pipeline would reduce the flow of developer fees to nonprofits. These fees, available only when new projects are financed, support operations, including asset and property management. The crisis has prompted calls for new, strategic, innovative approaches to finance affordable housing. Public Benefit Zoning is one of these.

One important approach to achieve public benefit zoning is to enhance a community's existing inclusionary housing program by requiring a higher percentage of inclusionary units than under the existing system without significant additional costs to the developer. In jurisdictions that already have inclusionary housing policies in place, this new approach could redefine inclusionary housing as a two-tiered process.

- The first tier would not change the inclusionary housing requirements required under the existing zoning framework. Thus, if a developer does not receive additional density or a land use change, the existing inclusionary housing policy would still apply.
- The second and higher tier(s) of inclusionary zoning would be in addition to the current requirement and would be associated with substantive plan changes or up-zonings of either specific parcels or larger areas. This can be accomplished without significant additional costs to the developer.

Similarly, Commercial Linkage Fees and Housing Impact Fees could be based on a two-tiered approach. The first tier would apply to existing zoning, and the second tier would be associated with plan changes/re-zonings. Since a majority of jurisdictions with commercial linkage fees and housing impact fees have adopted fees at levels lower than justified by nexus studies, this approach should not require new nexus studies and would still be defensible.

2) Additional Community Benefits

New development generates a need for new facilities. To meet that need, developers pay development impact fees that are reasonably related to the impacts created by new development. As in the case of traditional inclusionary housing, the development impact fees are not associated with a re-zoning, but generally paid at the time of approval of a subdivision plan, the issuance of building permits, or, in some cases, at the time of issuance of a certificate of occupancy or final completion. These fees generally only partially cover the need for new facilities. This is particularly the case where jurisdictions are concerned about discouraging development.

The result is a tremendous variety of fee levels and types of fees, with many localities charging much less than what is necessary to maintain adequate facility and infrastructure standards in the face of growth. It should be remembered that impact fees need to be reasonably related to the need created by the new development. Ironically, while state law requires that development impact fees be related and proportional to the need for public facilities, there is no state law or agency that addresses the issue of the inadequacy of the development impact fees to fund needed improvements.

Community benefits obtained through LVR, then, represent a creative opportunity to make sure that additional development and increased densities contribute to, not detract, from the community. This becomes imperative in the case of infill and densification. "No densities without amenities" could be the cry of neighborhoods impacted by densification and infill. A PBZ system could go a long way toward providing at least a portion of the necessary funding.

Community benefits obtained through LVR then, are in addition to the ones obtained through existing exactions.

CASE STUDIES

One of the best ways to understand how PBZ actually works is to study those cities which have already adopted a PBZ strategy. Information on four cities is presented here. San Francisco and Santa Monica are presented first, since these cities developed the most elaborate planning process for PBZ. Culver City is presented next. The City of Berkeley is presented at the end. Also, see Schildt (2012) for brief descriptions of San Diego and Palo Alto. These case studies indicate that there are many ways that cities have defined their policies. So far, there is no example of a PBZ policy adopted by a suburban city transitioning to denser development.

1) San Francisco, California (Eastern Neighborhoods)

It could be argued that Land Value Recapture in the United States was invented in San Francisco in the early part of this century. It came about as a result of the conflicts that arose from the dot.com boom of the late twentieth century, as certain areas east of Market Street – primarily the mostly Latino Mission District - experienced rapid increases in real estate values, gentrification, and displacement of families and businesses. This process was aided by city policies that exempted “live-work” spaces in warehouses and industrial structures from processing and fee requirements.

The story of that struggle has been told elsewhere and will not be repeated here (Fishman, 2006; Marti et. al., 2009, and Cohen & Marti, 2012). In this case study we will briefly explain how PBZ in San Francisco was an outcome of, and shaped by, those conflicts.

Public-Benefit Incentive Zoning

The coalition that formed to fight the changes occurring in their neighborhoods (the Mission Anti-Displacement Coalition - MAC) decided when the city initiated a planning process for those areas, that they would create their own plan, called the People’s Plan for Jobs, Housing, and Community. Instead of reacting to the City’s plans, the neighborhoods decided to establish first “what they wanted” and then “how to get it.”

As part of the People’s Plan preparation, the leaders of MAC came up with the idea of PBZ. They called it “Public Benefit Incentive Zoning” (PBIZ). They argued that increases in density create “greater value for property owners and sales or rental value for developers,” and that PBIZ, could create “a mechanism to capture a portion of this increased land value in the form of Public Benefits that would mitigate the impact of the additional development.” A menu of Public Benefits was included, with affordable housing on top of the list. Additionally, the plan called for

Eastern Neighborhoods PLAN AREA



SAN FRANCISCO PLANNING DEPARTMENT | APRIL 2008



The People's Plan for Jobs, Housing, and Community

The Mission Anti-Displacement Partnership

North East Mission Industrial Zone Rezoning Goals and Land Use Designations

DRAFT – Revised 3-22-2005

“a study analyzing the economic benefit conferred to the land as a result of the Mission District rezoning...in order to ascertain the financial feasibility of absorbing the exaction while maintaining an incentive for development” (MAP - The Mission Anti-Displacement Partnership, (33: 2005).

In two pages, the leaders of MAC had set up the rationale for utilizing PBZ to obtain public benefits through the planning process. While it is impressive that community activists could create such a sophisticated proposal for PBZ, it must be remembered that the planning culture and political environment in San Francisco is imbued with the principle that growth should pay for the costs it generates. This policy dates back to commercial linkage fees that were established in San Francisco in the early 1980's as a result of the surge of

office developments that were changing the face of downtown San Francisco. Opponents of the “Manhattanization” of San Francisco and affordable housing advocates found inspiration in the idea of “mitigation” that is an integral part of the California Environmental Quality Act, i.e. that the adverse environmental impact associated with development should be anticipated and mitigated. One adverse impact was that office development job growth resulted in an increased need for affordable housing. The mitigation to this impact were the office linkage fees established in San Francisco in 1985, requiring large office developments to contribute to an affordable housing trust fund that would help finance affordable housing. San Francisco was the first city in the country to adopt these fees.

In 2001, this program was re-named the Jobs-Housing Linkage Program (JHLP) and was revised to require all commercial projects with a net addition of 25,000 gross square feet or more to contribute to the fund. The linkage fees were extended to other commercial uses in 2001. In addition to the linkage fee for jobs and housing, San Francisco currently imposes development impact fees for transit and parks, in-lieu fees for child care facilities and inclusionary housing, and a capacity charge for wastewater treatment.

The idea of PBIZ was at first rejected by the City as anti-development in 2004. In the meantime, the planning department had begun a planning process for an area that included not only the Mission, but also Potrero Hill/Showplace Square, the eastern portion of South of Market and Central Waterfront – the so-called “Eastern Neighborhoods” (ENs). With the planners in charge of the planning process sympathetic to the goals of the MAC, the principle of LVR was eventually embraced by the City. The question remained as to how this recapture would work. The following sections present the process that was followed.

Needs Assessment

The first step consisted of assessing the existing and future needs in the ENs. This process would lead to the establishment of a “package” of public benefits. A needs analysis was performed consisting of two approaches. The first was an assessment of current and future needs for some key services and amenities completed by a consultant and based on a land-use scenario prepared by the Planning Department in 2003. A draft of the findings was published in September 2006, and the final consultant report was completed in May 2008. (Seifel Consulting Inc, 2008).

This standard-based/quantitative analysis produced a list of services/amenities that would be needed in the future that included, among others, recreational facilities, public health and human services centers, transportation and transit services and affordable housing. It also included projections for maintenance and operating expenses for parks and recreational facilities. The need for affordable housing was based on ABAG estimates that 64 percent of new housing production in San Francisco needed to be affordable. Within the Eastern Neighborhoods, this translated to 1,901 units affordable to very low-income households, 771 to low-income households and 2,044 to moderate-income households, for a total of 4,716 affordable units, over half of the 7,385 anticipated units.

The second approach was based on a series of meetings with the community. This so-called “Qualitative Analysis” incorporated the community feedback from numerous workshops that took place from September 2006 to March 2007 in various areas of the ENs.

As a result of these needs assessments, two major areas of concern were identified. First was the need for affordable housing in neighborhoods that traditionally had housed people working in the service and manufacturing industries in the ENs. Second was the need to fill the gap in the existing infrastructure and public facilities, and meet the needs generated by new development. The cost of the public benefits was calculated to be approximately \$300 million.

The Plan

The existing land uses in the Eastern Neighborhoods included for the most part underutilized industrial areas that became very appealing to speculators during the dot.com boom. Because of inadequate land use controls at the time, these developers could turn industrial buildings into “live-work” units, (but actually live-only spaces in the great majority of cases), with a simple conditional use permit, without paying development impact fees. This was potentially very profitable for developers who bought the land at lower, industrial prices, and eventually for landowners because it effectively converted industrial land into more valuable residential land that could command higher prices. The Plan’s main task was to identify the areas that could be changed from these “grey” areas (industrial but easily changeable to residential) to mixed use/residential, and those areas where industrial uses, mainly Production, Distribution and Repair uses (PDR) would remain. Much of the discussion was centered on the determination of how much of San Francisco’s remaining industrial lands should be transitioned to other



Potrero Launch, San Francisco, Photo Courtesy of Nico Calavita

uses, especially needed residential uses. PDR uses were maintained in the more traditional industrial zones. Also, while allowing density increases in all the ENs, the Plan allowed significant higher densities/height only in areas to the North of the ENs, close to Rincon Hill and the Central Business District.

Baseline and Bonus/Upzoning Fees

In addition to increases in density in all Eastern Neighborhood,

the Plan provided additional benefits to land owners and developers, including height increases, removal of conditional use permits for residential uses in all areas—except for PDR preservation districts—and changes in land-use designations from industrial in some areas to residential uses. The Eastern Neighborhoods Plan offered the ability to reduce the need for additional environmental studies by tiering off the EN Plan EIR.

These changes would generally increase the value of land covered by these provisions, since less expensive industrial land is converted to more valuable residential land, which presently is in high demand in San Francisco. In order to learn more about how much these changes enhanced land values, the City hired a consultant to prepare a residual land value analysis to estimate the enhanced value from these upzonings and land use changes. (An example of this residual land value analysis is presented at the end of this section.) It was based on a representative subset of nine prototypes combining different densities/heights and lot sizes. The analysis showed that “residual land values and profitability are generally higher under proposed

“
THE EASTERN
NEIGHBORHOOD PLAN
IN SAN FRANCISCO IS A
GOOD EXAMPLE OF THE
PLAN-BASED APPROACH”

Table A-1

FEE SCHEDULE FOR EASTERN NEIGHBORHOODS PLAN AREAS ⁽¹⁾

| Tier | Description | Residential | Commercial |
|------|--|-------------|------------|
| 1 | Projects that remain at current height. Projects under increased housing requirements (UMU), Affordable housing or other “protected” development types. | \$8/gsf | \$16/gsf |
| 2 | Projects rezoned with minimal (1-2 story) increase in height. | \$12/gsf | \$20/gsf |
| 3 | Projects rezoned with significant (3 or more) increase in height; other designated districts. | \$16/gsf | \$24/gsf |

(1) It should be noted that all fees are based on net addition of gross square feet (gsf) of any use type.

Source: City of San Francisco: Materials for Eastern Neighborhoods Area Plans Initiation Hearings, April 17, 2008.

zonings and requirements than under current zoning,” even though “value increases are offset to some extent by higher development costs associated with taller, denser development types” (Seifel Consulting Inc. 2008b). The question remained as to how, and how much of, this value could be recaptured for public benefits.

The City had two choices: (1) to recapture land values through individual project “deals,” utilizing development agreements or similar instruments or, (2) to establish a priori the level of public benefit to be expected, proportional to the benefit received, exercised through a system of fees. The City chose the second option - what we have labeled the “plan-based” approach. With this approach, the City “aimed to state clearly up front what benefit contributions will be, based on a proxy of benefit gained. The development community gains certainty about what will be required to contribute, and the neighborhood gains certainty about what improvements can be expected” (Seifel Consulting Inc. 2008b). The plan-based approach was especially attractive in a city like San Francisco, where the development process is perceived to be extremely politicized with deals conducted behind closed doors.

The bonus/upzoning fee was only one source of funding for the package of community benefits that had been identified through the needs analyses. Additional revenue sources identified to pay for benefits included the following:

- Baseline Impact Fees
- Assessment Districts
- Regional and State Funding

- General Fund
- Tax Increment¹³
- Grants & Bonds

Baseline impact fees are the fees that can legally be imposed on new development for the needs it creates for capital facilities such as libraries, transportation, recreation and parks and child care facilities. In addition, new development is subject to citywide exactions such as the Citywide Transit Impact Development Fees and the School Impact Fee. In May 2008 a consultant report was released that provided information on the maximum amount that could be charged. Similarly, a citywide housing nexus study prepared in 2006 established the maximum amount that could be required for affordable housing.

The Solution: A Tiered Program of Combined Fees and Housing Options

Tiered Approach

To reflect the relationship between higher densities and increased value for land and development, the City established a “Tier” approach to baseline fees and public benefit fees. (See Table 1Above.)

Baseline impact fees are paid by projects that remain at current height (Tier 1), because there is no increment in value resulting directly from governmental action, although values may have increased as housing demand and prices have spiked.

Table A-2

HOUSING REQUIREMENTS FOR THE UMU DISTRICT 12

| Tier | Description | On-Site Housing Requirement | Off-Site/ In-Lieu Requirement | Middle Income Alternative | Land Dedication Alternative |
|------|--|-----------------------------|-------------------------------|---------------------------|-----------------------------|
| A | Projects that remain at current height. | 18% | 23% | 40% | 35% |
| B | Projects in the UMU rezoned with minimal (1-2 story) increase in height. | 20% | 25% | 50% | 40% |
| C | Projects in the UMU rezoned with significant (3 or more) increase in height; other designated districts. | 22% | 27% | 60% | 50% |

Source: City of San Francisco: Materials for Eastern Neighborhoods Area Plans Initiation Hearings, April 17, 2008 (page 21)

In existing mixed-use areas, a second and third tier of impact fees are triggered where the Plan grants additional heights – specifically, Tier 2 applies to an increase of one to two stories, and Tier 3 applies when three or more stories are permitted. The fees for Tiers 2 and 3 constitute baseline fees plus additional public benefit zoning fees. Exempted from the fees were the following:

- (A) The residential portion of all 100% affordable housing projects, because they already provide affordable housing;
- (B) The residential portion of all projects within the Urban Mixed Use (UMU) district to encourage more mixed use development, and
- (C) All changes of use within existing structures to encourage rehabilitation activity.

The baseline impact fees were set at 85% to 95% of the full costs attributable to new development, to make sure that the fees did not exceed reasonable costs, and to make them “generally feasible under current market conditions.” In reference to the public benefit zoning fees, the EN Implementation document reiterated that the rezonings which allow greater height increase “see a significant increase in land value ... resulting in a more profitable project, which is therefore able to pay closer to its full of impact” (City of San Francisco Planning Department, Planning Commission, June 2008).

Notes to Table A-3 See Next Page

(Table A-3)

- a. Ground floor contains parking, entryway/lobby space, and potential neighborhood retail space in the remaining square footage. No costs or revenues are assumed for the ground floor other than those related to parking.
- b. Standard average unit size is 925 sf per recent development proposals. Average unit size increases up to 1,200 sf when density restrictions limit unit count under current zoning
- c. Unit per floor estimates are based on gross unit square footage and estimated floor area; estimates round up when unit calculations are within 0.25 of the next full unit.
- d. Maximum units under current zoning are constrained by density controls rather than building envelope limits.
- e. Onsite Below Market Rate (BMR) units equal 15% of total units, rounded to the nearest whole number.
- f. Parking ratio under current zoning is 1:1 for all units. Parking ratio under proposed zoning reflects 1:1 for 2+ bedroom units (40%) and .75:1 for 0-1 bedroom units (60%).
- g. Market rate sales prices and building costs based on Citywide Inclusionary/KMA building prototypes, adjusted to reflect current market conditions and variations in unit sizes.
- h. Market price of units without a parking space assumed to be \$50,000 less than units with parking. Average market price adjusted in proportion to the building’s parking ratio.
- i. BMR prices based on MOH 2008 sales prices and building unit mix. Actual BMR price adjusted according to MOH unbundled parking policy.
- j. In-Lieu fee \$0, as development is meeting housing requirements with onsite production.
- k. EN Impact Fee to be charged under proposed zoning only. Proposed fee amount is \$8 per gross residential square foot, or \$10 per net residential square foot with 80% efficiency.
- l. Return on net sales targets based on Citywide Inclusionary/KMA building prototypes.

Table A-3

RESIDUAL LAND VALUE

TIER 1, EXISTING RESIDENTIAL/COMMERCIAL ZONES, ONSITE IH SAN FRANCISCO EASTERN NEIGHBORHOODS

| | Current Zoning NC | Proposed Zoning NCT | Difference |
|--|---------------------------|---------------------------|---------------------------|
| Site Area and Zoning | | | |
| Lot Size | 20,000 Square Feet | 20,000 Square Feet | |
| Lot Acreage | 0.46 Acres | 0.46 Acres | |
| Ground Floor Lot Coverage ^a | 100% | 100% | |
| Maximum Residential Lot Coverage (Above Ground Floor) | 75% | 75% | |
| Maximum Residential Density | 600 Lot Sq. Ft. per Unit | N/A | Density Increase |
| Development Program | | | |
| Description | Low Rise Podium | Low Rise Podium | |
| Maximum Height | 50 Feet | 55 Feet | 5 Feet |
| Maximum Total Floors | 5 Floors | 5 Floors | 0 Floors |
| Building Efficiency | 80% | 80% | |
| Residential | | | |
| Average Unit Size ^b | 1,200 Square Feet | 925 Square Feet | |
| Units per Floor ^c | 10 Units | 13 Units | |
| Maximum Units ^d | 33 Units | 52 Units | 19 Units |
| Unit Mix | 0% 1 BR | 60% 1 BR | |
| | 80% 2 BR | 30% 2 BR | |
| | 20% 3 BR | 10% 3 BR | |
| Number of Market Rate Units | 28 Units | 44 Units | 16 Units |
| Number of BMR Units ^e | 5 Units | 8 Units | 3 Units |
| Parking | | | |
| Average Parking Ratio ^f | 1 Space per Unit | 0.85 Space per Unit | |
| Revenue | | | |
| Market Rate Sales Price ^g | \$717 Per Net Square Foot | \$754 Per Net Square Foot | |
| | \$859,891 Per MR Unit | \$697,718 Per MR Unit | |
| Average MR Sales Price Adjusted for Parking ^h | \$859,891 Per MR Unit | \$690,987 Per MR Unit | |
| Base Price of BMR Units ⁱ | \$242,771 Per BMR Unit | \$223,134 Per BMR Unit | |
| Sales Expense | 4.0% | 4.0% | |
| Sales Net of Sales Expense | \$24,413,318 | \$31,086,739 | \$6,673,421 |
| | \$739,798 Per Unit | \$597,822 Per Unit | |
| | \$616 Per NSF | \$646 Per NSF | |
| Building Costs^g | | | |
| Hard Construction (incl. parking) | \$276 Per NSF | \$289 Per NSF | |
| Governmental Fees | \$8 Per NSF | \$19 Per NSF | |
| Permits and Processing Charges | \$6,000 Per Unit | \$6,000 Per Unit | |
| Additional 2007 Water and Sewer Impact Fees | \$508 Per Unit | \$508 Per Unit | |
| Inclusionary Housing In-Lieu Fee ^j | \$0 Per Unit | \$0 Per Unit | |
| School Impact Fee | \$2.24 Per NSF | \$2.24 Per NSF | |
| Eastern Neighborhoods Impact Fee ^k | \$0 Per NSF | \$10.00 Per NSF | \$10 Per NSF |
| Other Soft Costs | \$100 Per NSF | \$100 Per NSF | |
| Construction Financing | \$28 Per NSF | \$28 Per NSF | |
| Total Building Costs | \$16,295,730 | \$20,941,517 | \$4,645,787 |
| | \$493,810 Per Unit | \$402,721 Per Unit | |
| | \$412 Per NSF | \$435 Per NSF | |
| Residual Land Value | | | |
| Return on Net Sales ^l | 15.4% | 15.4% | |
| Developer Margin | \$ 3,759,651 | \$ 4,787,358 | \$1,027,707 |
| | \$113,929 Per Unit | \$92,065 Per Unit | |
| Land Value | | | |
| Per Unit | \$132,059 Per Unit | \$103,036 Per Unit | -\$29,023 Per Unit |
| Per Net Residential Square Foot | \$110 Per NRSF | \$111 Per NRSF | \$1 Per NRSF |
| Per Gross Residential Square Foot | \$88 Per GRSF | \$89 Per GRSF | \$1 Per GRSF |
| Per Lot Square Foot | \$218 Per LSF | \$268 Per LSF | \$50 Per LSF |
| Per Acre of Land | \$9,491,587 Per Acre | \$11,669,429 Per Acre | \$2,177,842 Per Acre |
| Representative Site Land Value | \$4,357,937 | \$5,357,865 | \$999,928 |
| Site value increase as a percent of current zoning base | | | 22.9% |

Source: Eastern Neighborhoods Impact Fee and Affordable Housing Analysis, Prepared by Seifel Consulting for the City of San Francisco (May 22, 2008).

Increased Inclusionary Housing Requirements

To fulfill the goal of increased affordable housing production in the ENs, the Plan also requires that in areas rezoned from industrial to mixed, mostly residential uses (UMU), more affordable housing be produced than is required under the City's inclusionary program. Within these zones, the Plan provides greater flexibility in the way affordable housing requirements can be met so that higher percentages of affordability are actually achievable (see Table 2 page 24). Thus, properties that are rezoned from industrial to mixed land uses are responsible to meet inclusionary housing requirements as well as pay fees under the City's Program.

Example of a Residual Land Value Analysis

Table 3 (at right) provides an example of a residual land value analysis that can be used to estimate the value enhancement from proposed zoning. The table is taken from a memorandum prepared for the San Francisco Planning Department by Seifel Consulting Inc. in May 2008: "Eastern Neighborhoods Impact Fee and Affordable Housing Analysis." The table is one of the tables prepared as part of the financial analyses performed on typical sites in the Eastern Neighborhoods under different heights assumptions. This analysis provided the basis for the decision making process that led to the fee schedule in the Eastern Neighborhoods.

Implementation

The base public benefit fee of \$8 for residential gsf and \$16 for commercial gsf are dedicated to fund capital infrastructure (open space and recreational facilities, transit, streetscape and public realm improvements). Fees above that base level are also intended for infrastructure funding, but a small percentage of those funds can also be dedicated to community facilities, such as child care and library materials.

To help implement the Plan, the Eastern Neighborhoods Citizen's Advisory Committee (EN CAC) was established by the City. According to the City's website - "The EN CAC is the community advisory body charged with providing input to City agencies and decision makers with regard to all activities related to implementation of the Eastern Neighborhoods Area Plans. The CAC is established for the purposes of providing input on the prioritization of Public Benefits, updating the Public Benefits program, relaying information to community members in each of the four neighborhoods regarding the status of development proposals in the Eastern Neighborhoods, and providing input to plan area monitoring efforts as appropriate."

The CAC's recommendations are coordinated with the Interagency Planning and Implementation Committee and the Capital Program Committee.

Given the real estate decline that began at the same time the EN Plan was approved, the amount of fees collected thus far has been rather small, generating frustration among CAC members. Additionally, to encourage development, the City established a fee deferral process. However, as of early 2014, market activity has picked up considerably, and developments are now paying Public Benefit fees.

One drawback of this plan, with its emphasis on certainty and legal care, is that there may not be quick responses to changing real estate market conditions. Whereas fees were deferred during a period when the market was slow, they cannot be increased quickly when the market has recovered. Land values are increasing sharply, in spite of the Public Benefits requirements. It is likely that fees could be increased beyond the adopted fee schedule at this time, while maintaining financial feasibility of new projects.



1318 2nd Street is a mixed use Tier 2 development that was allowed to add additional height in exchange for affordable housing. Rendering Courtesy David Forbes Hibbert, AIA Architects

2) Santa Monica, California

Santa Monica has a long-standing tradition of achieving community benefits through development agreements, including parks and park improvements, community health access, and child care centers with subsidies for low-income families.

In 2010, after many years of extensive community engagement, the City adopted the Land Use and Circulation Element (LUCE). The fundamental goal that guided the LUCE process was that additional development and increased densities must contribute to, not detract from, the quality of life in the community. The requirement for new development to provide City-negotiated community benefits stems from this goal. As stated in a City document—“The LUCE ties together land use, market economics and social aspects of the community by requiring that future development funds a range of measurable public benefits, from open spaces and parks to affordable housing.”¹⁴



AN ESSENTIAL STEP IN THE NEGOTIATION PROCESS BETWEEN THE CITY AND DEVELOPERS/LAND OWNERS IS THE ESTABLISHMENT OF THE “ENHANCED VALUE” OF THE LAND CREATED BY GREATER HEIGHT AND FAR

As part of the LUCE preparation, preliminary economic analyses that evaluated the extent of enhanced land value resulting from higher densities were performed. These analyses indicated that projects that would provide community benefits under LUCE were able to achieve financial feasibility (Keyser Marston Associates, 2010).

LUCE established a community benefits tier structure with projects requesting an increase in the base height of 32 feet to undergo a discretionary review process. There are three tiers.



Santa Monica's LUCE Activity Centers

- Tier 1 establishes the base height and FAR. No community benefits in addition to the existing ones are required and the approval process is ministerial. Three to seven extra feet are allowed if affordable housing is provided on-site or close to transit corridors.
- Tier 2 allows additional height and FAR when community benefits are provided.
- With Tier 3 even more height and FAR are allowed in exchange for higher levels of community benefits. It is when developers seek tier 3 density increases that development agreements are required. This process requires additional public review and flexibility that, through greater discretion, encourages high-quality projects. Tier 3 projects are larger in scale and development agreements provide developers with a greater degree of entitlement certainty.

How Do Tiers 2 and 3 Actually Work?

The level of amenities for Tiers 2 and 3 is decided through negotiations at the project level and is based on a financial benefits assessment.

- The first step in the negotiation process is to establish, through economic analyses, the “enhanced value” created by greater height and FAR as well as proformas that identify the “internal rate of return.” Consultants employed by the developer prepare this analysis that is then reviewed by consultants to the City in a give-and-take process referred to as a peer-review process, that ends when both consultants agree on the soundness of the analysis.

- The second step involves determining the types and levels of community benefits. It should be remembered that there are already “project benefits” requirements in the Municipal Code that are the subject of impact fees or contributions and include the following:¹⁵
 1. Affordable Housing Production Program
 2. Childcare Linkage Program
 3. Developer Cultural Arts Contribution
 4. Parks and Recreation Facilities Tax
 5. Parks and Housing Fee
 6. Transportation Management Ordinance
 7. Transportation Impact Fee (to be adopted)



**INTERNAL RATE OF RETURN
COMPARES THE PRESENT VALUE
OF THE EXPECTED FUTURE CASH FLOWS
TO THE INITIAL CAPITAL INVESTED.
IT IS ONLY ONE WAY TO ANALYZE THE
VALUE OF THE INVESTMENT.”**

The additional LUCE community benefits, on the other hand, are negotiated on a project-by-project basis, and are based on the five categories that were identified, through intense community involvement leading to the establishment of LUCE. They are as follows:

- New Affordable and Workforce Housing
- GHG Emissions and Future Congestion Reduction Requirement
- Community Physical Improvements
- Social, Cultural, and Educational Facilities
- Historic Preservation

These broad categories, refined during the preparation of Specific Area Plans, guide the initial discussion of the development agreement process. But each project is unique, as is its relationship to the specific neighborhood in which it is located, with its particular characteristics and needs, providing the opportunity for community residents and interested parties to comment on the project and its potential community benefits.

This early stage in the project review is called the “float-up process” and—in addition to public involvement—includes Planning Commission and City Council input. The resulting list of community benefits is then reviewed by an interdepartmental working group comprised of the department heads responsible for services such as housing, social services, transportation, and parks and open space. Congestion reduction is expected from all projects.

The third step addresses financial feasibility to determine the highest levels of community benefits possible without making the project economically infeasible.

Problems with Development Agreements in Santa Monica

The greatest attraction of development agreements is their flexibility. They provide greater assurance for developers and more regulatory flexibility for the City in achieving policy goals. It “has greater public review and participation, allows more flexibility to create high-quality projects and achieve greater community benefit, providing the greatest discretionary control to the City” (City of Santa Monica, May 2008).

On the other hand, development agreements consume considerable City resources and staff and decision-makers time. In 2012 there were 24 development agreements that had been approved or were pending since the adoption of LUCE in 2010. Most of these projects are located in downtown Santa Monica, Wilshire Boulevard and the former industrial area of Bergamotte. Given the number of development agreements, it is not surprising that Santa Monica is seeking alternatives to development agreements for smaller (mostly Tier 2) projects. In a paper prepared for the City - “Community Benefits and Incentives: Issues, Options, and Case Studies” the consultants, after reviewing the issues for Santa Monica and approaches to community benefits in peer communities, recommended a Conditional Use Permit Process for Tier 2 projects that would have developers either choose benefits from a specific list or propose benefits that would be found to meet LUCE goals. The “bonus value/criteria may be expressed by a points system, based on construction value, or as binary thresholds (e.g. incorporating at least X square feet of publicly accessible open space for every Y square feet of office space). These criteria may be used in combination” (Dyett & Bathia, August 2012).

The city is now considering a “plan-based” approach, as in San Francisco and a ministerial entitlement based on compliance determination – as an alternative to development agreements.

3) Culver City, California

Background

Culver City adopted a Community Benefit Incentive Program in connection with revisions to its Zoning Code governing Mixed Use Development Standards in February 2008. The Ordinance replaced an earlier Ordinance that permitted a residential density of up to 65 dwelling units per acre in the Mixed Use Zone.¹⁶ The revised Ordinance reduced this density to 35 dwelling units per acre because there was community concern that the development standards were incompatible with surrounding land uses and generated negative traffic impacts. However, this Mixed-Use Ordinance includes a provision that allows mixed-use development to obtain density increases in return for provision of community benefits. Densities can be increased up to 50 dwelling units per acre in return for the project’s provision of community benefits, such as public parking, open space, streetscape improvements, green building construction meeting LEED Silver energy efficiency standards, or other City identified benefits that serve the immediately impacted neighborhood.¹⁷

Approach Used to Estimate Level of Community Benefits¹⁸

The value enhancement related to density increases, e.g. from 35 dwelling units per acre to 50 dwelling units per acre, is calculated using an incremental profit approach. In this way, the increase in value is calculated only on the additional units that are possible and not over the entire project. The calculation of profit is based on collaboration between the developer and the City and is successful in those situations in which the increase in profit is high enough so that the developer concludes that the project is still feasible, given the additional costs of community benefits. A succinct definition of the value enhancement is as follows: the number of additional dwelling units allowed multiplied by the market value sales price of these units multiplied by 15% (assumed developer profit in the Ordinance).¹⁹

The calculation methodology minimizes the number of subjective assumptions, but still requires staff time in working with the developer. The following steps summarize the way in which value enhancement is calculated.

- Identify the increase in the number of dwelling units.
- Estimate the market value per unit by appraisal or market study.
- Apply an agreed upon threshold profit percentage. (This can be complicated, because the developer and the City may not assume the same profit percentage.)
- The final step is to calculate the community benefits contribution which is equal to 50% of the value enhancement.

The Mixed-Use Ordinance (Section 17.4000.065 of the Zoning Code) specifies the details of the Community Benefits Incentive Program, including a process for establishing benefits related to specific projects. This process includes meetings with community members. The benefits may be provided either on-site and maintained for the life of the project, or the benefit may be part of a public improvement, for which the developer would pay an in-lieu fee. The Ordinance also includes a monitoring process.

4) Berkeley, California (Downtown Area Plan)

Origins of Plan and Adoption Process

The Downtown Area Plan is designed to revitalize Berkeley's Central Business District which had been in decline for several decades. The current Downtown Area Plan, adopted by the City Council in Spring 2012 replaced the 1990 Downtown Plan. The impetus for replacing the 1990 plan stemmed from a lawsuit (on environmental concerns) in 2002 that the City filed against the University of California's (Berkeley campus) Long Range Development Plan. The new Downtown Area Plan was approved in 2009, but was rescinded in 2010, after a referendum campaign received 9,200 signatures to place an opposition measure on the ballot.²⁰ In its place, voters approved Measure R in 2010. The current Area Plan is consistent with Measure R and was adopted by the City Council in 2012.²¹



*Oxford Plaza, Berkeley, Resources for Community Development.
Photo Courtesy RCD*

Plan Interpretation

The Downtown Area Plan addresses many issues related to new development, including height limitations, a “Green Pathway” development review process (that provides a streamlined permit process), parking requirements, open space, and impact fees.²² Impact fees, such as the Streets and Open Space Improvement Plan fees (SOSIP) and housing mitigation fees, are required of all new developments. In addition, developments that request building heights that exceed 75 feet are required to provide additional public benefits. This is the one aspect of the Plan which links higher densities, land value recapture, and public benefits.²³

This policy from the Downtown Area Plan is codified in Berkeley's Municipal Ordinance (23E.68.090 Findings):

E. In order to approve a Use Permit for buildings over 75 feet in height under Section 23E.68.070.B, the Board must find that the project will provide significant community benefits, either directly or by providing funding for such benefits to the satisfaction of the City, beyond what would otherwise be required by the City. These may include, but are not limited to: affordable housing, supportive social services, green features, open space, transportation demand management features, job training, and/or employment opportunities. The applicable public benefit requirements of this Chapter shall be included as conditions of approval and the owner shall enter into a written agreement that shall be binding on all successors in interest.

As of April 2013, these benefits have not yet been defined, since no project had applied for this height variance. However, The Residences at Berkeley Plaza, a 355-unit, 17-story rental high-rise has now been proposed. This will be the first project required to negotiate public benefits. The responsibility for this will be the Zoning Adjustment Board. This project will take at least 12 to 18 months to get started, since an EIR is being prepared.

Ongoing Implementation Considerations

Berkeley has not defined a fixed relationship between increased densities or heights and the benefits that would be required. According to Berkeley’s Planning Director, the city attorney is concerned that, if this type of “table” were developed, it could be necessary to support requirements through a nexus study. The City wants to avoid this possibility, since it is possible that some benefits could not be justified through a nexus study. One example of this is local hiring on construction projects, required for the Green Pathway development review process. Since this streamlined review is voluntary, a nexus study is not required. Therefore, it is necessary to negotiate the public benefits that will be required each time a development requests heights in excess of 75 feet.

Conclusions and Recommendations

At a time when local governments search for ways to pay for needed improvements, services, and affordable housing, there is a valuable tool for many cities to consider is Public Benefit Zoning (PBZ). This White Paper has described this tool and provides examples of its use in cities in California. It works as follows:

When land is up-zoned or a plan updated to allow greater intensity of development, the value of the land generally increases. Most of this increase in value is the result of a public action and, for the most part, not due to actions undertaken by the landowner. When understood in this light, a strong argument can be made for the public to receive a reasonable share of the increased land value, to be used for community benefits. The technical planning term for this approach is “Land Value Recapture.”

The paper has reviewed the economics, types of community benefits and specified the differences between PBZ and other value capture tools. It describes various implementation approaches, what happens when market conditions make it infeasible, and outlines legal

considerations. Finally, it provides four extended California case studies – San Francisco, Santa Monica, Culver City, and Berkeley.

A separate final report explores the potential use of PBZ in four East Bay cities – Fremont, El Cerrito, Walnut Creek and Concord.

What lessons does the White Paper provide? What should localities do when contemplating Public Benefit Zoning (PBZ)?

Recommendations

- Evaluate the locality’s market strength through economic development economics, preferably a “Residual Land Value Analysis.” Encourage and enlist other neighboring localities to conduct such a study jointly.
- If economic studies indicate a viable market for higher densities, a general policy declaring that the city will pursue community benefits—in addition to existing Development Impact Fees, Inclusionary Housing and Commercial Linkage Fees—should be adopted.
- Establish with the relevant community a preliminary list of desired community benefits.
- Choose the planning approach that works best for the community. For example, in the case of a community-based plan—such as a specific plan—a “plan-based approach” would be desirable. For larger, individual parcels, a negotiated process with the land owner/developer would be best.
- In both cases, economic analyses that establish the value of the land before and after the land use/zoning changes are necessary. Then it is up to the legislative body to decide how much of the “value enhancement,” or “lift,” to recapture with community benefits.
- Establish the costs of the various community benefits.
- With an understanding of the costs and benefits to the land owner and developer, establish the specific community benefits, based on the recommendations of the community and city staff.
- Set in place an evaluation mechanism to be employed on a regular basis.

In localities where the market is weak, it is very tempting to up-zone properties, with the hope that they will become more attractive to developers. While that is understandable, the upzoning would eliminate any possibility for community benefits when the market improves. Downtown and Chinatown in Oakland are examples of areas where development interest is growing, but upzonings occurred prematurely. Inability to extract some of the land value increases resulting from the improving market will lead to development lacking the community amenities that would make the city even more attractive to buyers and renters. Localities should resist the impulse to up-zone no matter what.

This point warrants repeating: localities—all localities—should delay rezoning until Public Benefit Zoning policies are established. In weak markets, it could be possible to establish a “trigger mechanism” that phases in Public Benefit Zoning (see page 12).

Although PBZ is not as well known in this country as are other mechanisms that harness market forces to bring benefits to the public, such as incentive zoning, it is the only one that explicitly attempts to capture land value increases.

PBZ is based on the understanding, that, in large part, the increases in land value are due to the growth of the region, publicly funded infrastructure and, more specifically, planning decisions—that is, public actions. Seen in this light it is only fair and equitable that landowners should share the benefits that the rest of us have bestowed upon them, by contributing to the betterment of the public city. ❖

Endnotes

- ¹In this paper we will use these terms interchangeably
- ²By providing concessions, including increased density, an inclusionary housing mandate would be consistent with California State Law under the Palmer Decision.
- ³There have been numerous studies documenting the impact of BART on property values. For the most recent study, see the research study prepared by the Center for Neighborhood Technology.
- ⁴The great majority of PDAs coincide with “Communities of Concern,” defined as areas of concentrations of socioeconomically disadvantaged or vulnerable populations.
- ⁵In this paper we will use these terms interchangeably
- ⁶Landis and Cervero.
- ⁷It is in those situations (negative residual land values) that government intervention is necessary to subsidize private developers – the situation that had applied to publicly assisted urban redevelopment.
- ⁸In real estate investment, rental property’s value is based on net income flows (gross rents minus all operating expenses) that the property can generate over the intended holding period. The potential value is estimated by solving the following equation:
- Property Value = Net Operating Income divided by a Capitalization Rate.**
- The capitalization rate varies by market conditions and may be estimated based on recent sales of income property.
- ⁹Communities of concern are defined as areas with low-income and minority populations.
- ¹⁰It should be noted that the level of community benefits desired by community members is almost always greater than the level that is financially feasible for new development.
- ¹¹One example of a trigger used in an inclusionary housing program is an increase in annual building permits above a defined threshold. The threshold is based on historic building permit data.
- ¹²For example, in FY 2009-10, California redevelopment agencies reported that over \$ one billion was available and unencumbered to be spent on affordable housing. These funds are no longer available on an ongoing basis.
- ¹³This is no longer an option for California cities.
- ¹⁴City of Santa Monica (2008), p. 3.
- ¹⁵“These fees and contributions represent baseline requirements and constitute a negotiation floor for development agreements” (City of Santa Monica. 2012. p. 14).
- ¹⁶This code applies to specific streets within the City.
- ¹⁷City of Culver City, California, City Council Agenda Item Report February 11, 2008, accessed at <http://www.culvercity.org/sirepub/pubmtgframe.aspx?meetid=273&doctype=Agenda>. Note that affordable housing is not mentioned as a specific benefit.
- ¹⁸This section is based on information provided by Keyser Marston at the Sustainable San Diego Workshop – Crafting the New Normal: Tools for Urban [Re] Investment, December 7, 2012 and from Culver City’s revised Ordinance (Section 17.400.065 of the Zoning Code).
- ¹⁹Since the actual profit could be below or above the 15% benchmark, the actual profit percentage to be used would be negotiated between the developer and the City.
- ²⁰The City Council rescinded the Plan, so this measure was never placed on the ballot.
- ²¹According to Berkeley’s Planning Director, it is possible that a vote would be required to approve any changes to the Downtown Area Plan that would be inconsistent with Measure R. Since most plans are not passed through a vote of the electorate, this makes Berkeley’s Downtown Area Plan somewhat unique.

Endnotes

²²The Green Pathway development review process provides a streamlined permit process in return for requirements to mitigate air quality, noise, and shorter-term construction impacts, as well as possible disturbance of archeological resources. In addition, other benefits are required, including 20% affordable rental housing or payment of a housing fee, and employment of local construction workers. The Green Pathway option would not be considered a value capture policy, because developers do not receive higher densities, and instead benefit from streamlined review.

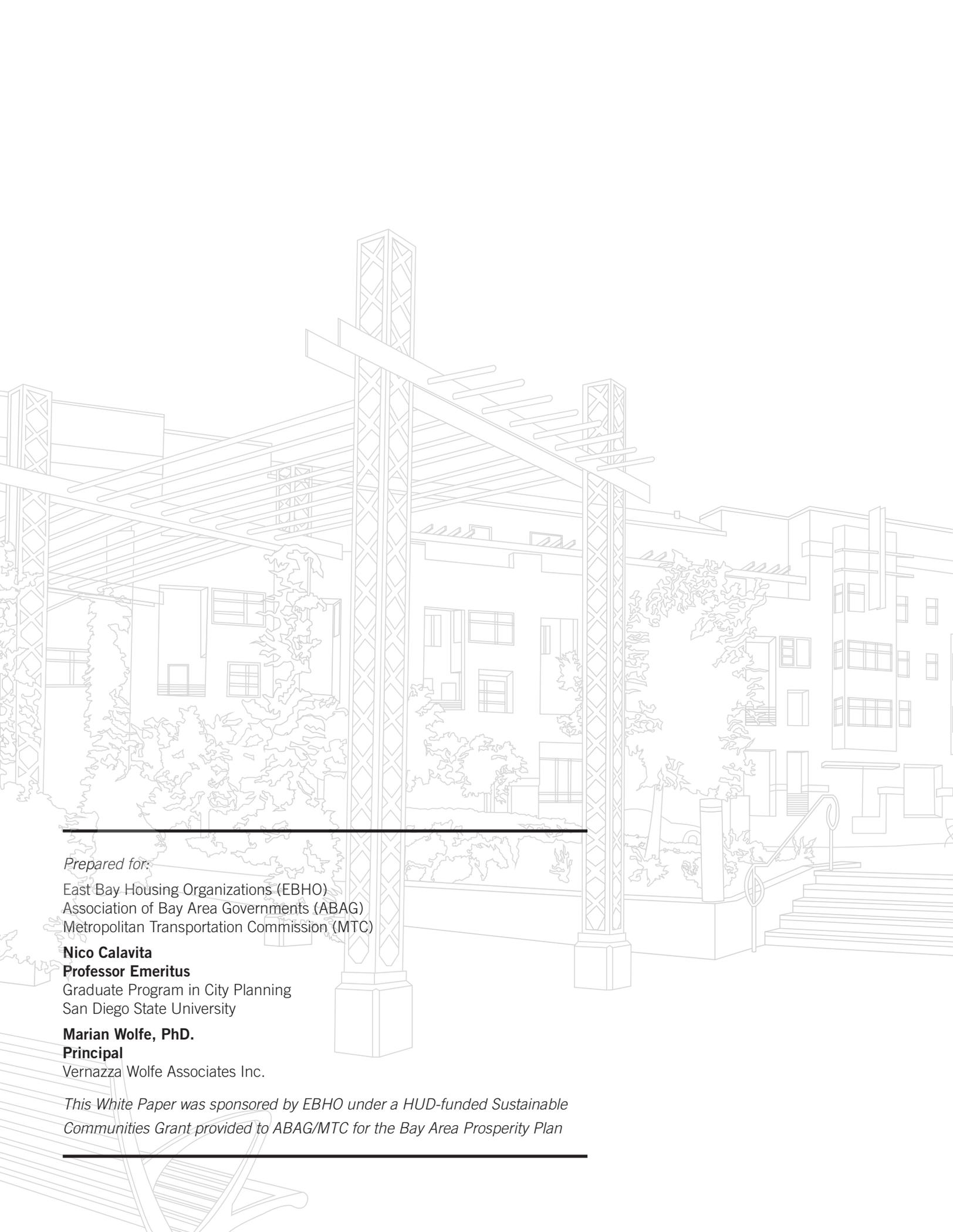
²³See Policy LU-2.2: Additional Community Benefits for Buildings Exceeding 75 feet (Downtown Area Plan, page LU-13). This is also cited in the Municipal Ordinance (23E.68.090).

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