

From: [John Kelley](#)
To: [Council, City](#)
Subject: PA-POLI: Letter to PACC re Agenda Item #3 re Impact Fees
Date: Sunday, September 22, 2024 11:47:30 PM
Attachments: [PA-POLI-letter to PACC re Adopt an Ordinance Amending the Municipal Fee Schedule re Impact Fees 2024-09-21 - with attachment.pdf](#)

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TO: Palo Alto City Council (City Council)
RE: Recommendations re Agenda Item #3 (Consent Calendar item #2)
“Adopt an Ordinance Amending the Municipal Fee Schedule to Modify the Calculation for Park, Community Center and Library
Development Impact Fees From per Unit to per Square Feet for Residential Development.
[etc.]” and Comments re Staff
Report 2408-3404 (Staff Report)
DATE: Sept. 22, 2024
FROM: John Kelley

RECOMMENDATION

Because the Staff Report and its attachments fail to provide essential information, present a restricted set of policy options, and contain apparent inconsistencies, the City Council should (a) defer consideration of this matter, (b) solicit additional data and other input, and (c) direct City Staff to present a revised report before reconsidering this matter in early November.

Please see the attached letter.

TO: Palo Alto City Council (City Council)
RE: Recommendations re Agenda Item #3 (Consent Calendar item #2)
“Adopt an Ordinance Amending the Municipal Fee Schedule to Modify the
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DISCUSSION

While a half-step forward in the right direction, the proposed ordinance does not take Palo Alto far enough to end its inequitable, irrational, and possibly improper impact fee regime.

Especially when evaluating public policies, it is vital to distinguish between a bearing and a vector. The Staff Report moves in the right direction, but not far enough.

It would be uncharitable not to recognize City Staff’s attempts to reform the Municipal Fee Schedule regarding impact fees. The City has admitted in its recently approved Housing Element that Palo Alto’s current, per-unit impact fees have “led to some inequitable results....”¹ City Staff have headed in the right direction in recommending that the City Council “modify the calculation of Park, Community Center, and Library Development Impact Fees for residential development from a per dwelling unit basis to a per square foot basis.” Staff Report, p. 2. But knowing that one must move in a certain direction is different from recognizing how far one must travel to reach one’s appropriate destination.

The newly proposed impact fees in the Staff Report remain remarkably and intolerably high. Should one building a 1400-sf apartment or condominium be required to spend almost \$70,000 for supposed impacts to Palo Alto’s parks, community center facilities, and libraries? Is it fair to demand such fees from contractors and others building multi-family projects, which are generally more environmentally friendly, when those building single-family homes more than twice as large — 4000 sf — would only be

¹ “[2023-2031 Housing Element, City of Palo Alto \(~July 2024, "Palo-Alto-Housing-Element-6"\)](#) (Housing Element V6),” Staff Report, p. 5, Housing Element V6, p. 4-65.

charged about 20% more, \$84,000? Proposed impact fees ranging from approximately \$42,000 to \$84,000 for sample projects – based upon a combined, per-square-foot rate of \$21.10, or higher (Staff Report, p. 4, “Table 3: Framework 1 – Distinct Rates and Sample Impact Fees”) – are economically onerous and will depress housing production. They perpetuate implicit and explicit fiscal discrimination against smaller homes, including apartments, condominiums, etc., and act as an anti-multi-family housing tax. Palo Alto can and should do better, and the City Council should be presented with a more robust set of policy options.

A revised report should make clear whether the proposed Municipal Fee Schedule actually embodies a per-square-foot impact analysis.

The inequitable treatment of smaller homes, whether on multi-family or single-family parcels, results not only from the comparatively enormous housing taxes placed on apartments, condominiums, and larger ADUs, but also from Palo Alto’s current policies of only imposing impact fees on “new” single-family homes. Additions, and even complete “scrapes,” receive free passes. As explained previously,²

Under Palo Alto’s current per-unit impact fee regime as applied to parcels with existing single-family homes, a property owner substantially adding to or completely scraping a 2,000 sf primary dwelling and replacing it with a 5,000 sf or larger primary dwelling will pay no impact fees at all, whereas the builder of ten 500 sf studios — having a total of 5,000 sf — might pay over \$500,000 in FY2025 for Park Impact Fees alone.

The Staff Report fails to make clear, among other things, (a) how ADUs will be treated under the proposed, new Municipal Fee Schedule, (b) whether additions to single-family homes or complete scrapes will be assessed impact fees, and (c) whether basements will be included in the calculation of square footage. From the current Staff Report, one might suppose that City Staff recommend assessing ADUs that are greater than 750 sf in size at a flat rate of \$21.10 per square foot (or \$16,880 for an 800-sf ADU), thus ignoring other policy alternatives (discussed below), and failing to consider the prodigious economic effects of such a housing tax on relatively smaller homes. But Staff Report’s actual treatment of single-family homes remains obscure. A single emphasized word in a footnote to Table 5, among other things, suggests that adoption of the proposed new Municipal Fee Schedule would not alter Palo Alto’s current practice of giving additions and scrapes free passes: “20 new single-family residential units in FY 2023-24.” Staff Report, p. 6, fn. 2 (emphasis in the original). What does the emphasis signify? Although actual data are not presented in the Staff Report, it is difficult to imagine that the total number of single-family homes in Palo Alto constructed during FY 2023-2024 that were either (a) “new,” (b) “newly expanded,” or (c) scraped was only 20. Unless otherwise indicated in an updated report, one must assume that the recommendations in the Staff Report continue to privilege single-family homes in crucial ways, thus failing to embody a truly comprehensive per-square-foot impact analysis.

² Letter to City Council dated June 17, 2024 (June 12, 2024 Letter), Attachment A, at p. 2.

A revised report should provide vital data upon which reasonable decisions will ultimately depend.

City Staff should be commended for at least acknowledging that the City Council could decide to further change and reduce the proposed impact fees, both to end inequities and to cease privileging single-family homes. The Staff Report notes, for example:

DTA was able to evaluate and present both frameworks due to the large sample of building permit data available from Palo Alto. Because these are proposed maximum fee levels, City Council has the discretion to determine which framework and fee level to adopt, including imposing a lower fee. Staff Report, p. 5.

That said, it is disappointing that the Staff Report does not provide the types and the requisite detail of data to evaluate vital policy alternatives. A revised report should provide:

- A revised Attachment 1, covering at least the same time periods as the current version for both single-family and multi-family homes, but also
 - including (a) new construction, (b) additions, (c) demolition permits (showing the size of existing structures being demolished), and (d) ADUs,
 - for each type of project,
 - showing impact fees actually assessed, and
 - how, if at all, they were partially assessed between new construction, scrapes, and additions, and
 - for each payment of impact fees, showing the date, fiscal year, and basis upon which the impact fees were imposed.
- A detailed explanation of how money from impact fees has been spent since the tremendous increases first went into effect in FY 2022 (*compare* Staff Report, p. 3).
- Data showing changes in Palo Alto's estimated population by year from 2020 through 2031.
 - At a fundamental level, residential impact fee analyses rest upon an assumption that demand for civic services grows with increased housing. But there is at least anecdotal evidence that Palo Alto's population, in addition to rapidly aging, has stabilized, if not declined, despite the residential construction detailed in the Staff Report.
- At least a brief update on the implications of *Sheetz v. County of El Dorado, California*, Syllabus (601 U. S. ____ (2024)), and its progeny, because that case, and likely future appellate decisions, may substantially alter the entire framework within which impact fees may be assessed.³

³ Attachment A, at p. 2.

**A revised report should examine, and,
as necessary resolve, apparent inconsistencies in the Staff Report.**

Certain statements in the Staff Report appear to be either internally or externally inconsistent.

- The Executive Summary states in part, at p. 2 of the Staff Report:
 - This amendment aligns with the City’s newly certified Housing Element and addresses Program 3.1: Fee Waivers and Adjustments, aimed at balancing the need for public facility funding with the promotion of housing affordability.
 - At the same time, the Staff Report
 - provides little information about the specifics of the asserted “need for public facility funding,” and
 - suggests that impact fees for larger multi-family units could increase from \$56,206 to \$69,986.00 or more. *Compare* Tables 2 and 3 at p. 2 of the Staff Report.
 - If City Staff believe that Program 3.1 will be advanced by imposing ever greater housing taxes on two- and three-bedroom apartments and condominiums — precisely the types of multi-family housing in which younger generations might desire to start families and into which older generations might seek to downsize, thus freeing up existing single-family homes — additional discussion and analysis would be warranted.
- In comparing the Distinct Rate and Consolidated Rate frameworks, the Staff Report states, at p. 5, “Conversion of this fee will complete one of the objectives under Program 3.1: Fee Waivers and Adjustments in the Housing Element.” Respectfully, this remains to be seen, depending, to a large extent on how other issues raised by the Staff Report are resolved.
 - “PROGRAM 3.1: FEE WAIVERS AND ADJUSTMENTS,” objective C, states in part, “By September 2024, complete and implement studies to convert existing park, community center, and library development impact fees that are applied on a per unit basis to a per square foot basis.”
 - As discussed above at p. 2, unless otherwise indicated in an updated report, the Staff Report appears to continue to privilege single-family homes in crucial ways, thus failing to embody a truly comprehensive per-square-foot impact analysis.
 - Thus, in the absence of additional information and clarification, adopting the proposed ordinance will be insufficient to satisfy the explicit requirements of Program 3.1, objective C.
- Attachment A to the Staff Report, the August 20,2024 DTA memorandum, “Second Supplement to the Development Impact Fee Justification – Assembly Bill (“AB”) 602 Compliance” (August 20,2024 DTA Memo), appears (a) not to consider ADUs as a distinct land use type, and (b) imply that the City will produce considerably fewer housing units in the 2021-2040 period than the RHNA targets in Housing Element V6. Housing Element V6, p. 2-75.

- *Compare* August 20,2024 DTA Memo, p.4, Table 3, and especially “Land Use Type” column and fn. 2, with “TABLE 2-34 ABAG’S NEW CONSTRUCTION NEED BY HOUSEHOLD INCOME LEVEL IN PALO ALTO, 2023-2031,” Housing Element V6, p. 2-75.
- Given the distinct characteristics of ADUs, their relative importance in Housing Element V6 to Palo Alto’s meeting its RHNA goals, and the specificity of those goals in the Housing Element V6, such apparent inconsistencies should be resolved.

A revised report should provide the City Council with a broader range of policy alternatives and a bolder vision for advancing impact fee reform to meet Palo Alto’s commitments in the approved Housing Element V6.

Again, City Staff should be applauded for at least noting the City Council’s power to reduce the proposed impact fees, but the Staff Report would be improved greatly were it to make additional, specific recommendations to achieve such ends, including the following:

- It could exclude 750 sf from the calculation of all impact fees, treating that size threshold as a minimum home size — whether single-family, condominium, apartment, or ADU — that should be free of all housing taxes, particularly in an era of possibly declining and likely aging population change, and reduced public school enrollment. Over the life of Housing Element V6, the real problem that Palo Alto may face is not overutilization, but rather underutilization of parks, community center facilities, and libraries. Without utilization, public support for such civic assets may wither. In these respects, a revised report ought to make clear the difference between use of impact fees for capital expenditures, as opposed to operating expenses.
- Public confidence in the overall level of impact fees requires that a revised report demonstrate (a) the actual purposes to which revenues from the greatly heightened impact fees over the last few years have been put, and (b) the specific projects that might be funded in the future after further changes are made in the Municipal Fee Schedule. Although not detailed in the Staff Report, recent annual reports on development impact fees make it difficult to assess (a) the percentage of such fees assessed on single-family homes, on the one hand, versus apartments, condominiums, and ADUs, on the other hand, and (b) the precise ways in which such funds have been used.
 - The Staff Report shows no estimated park, community center, or library impact fee revenues from multi-family homes in FY 2023-24 (Staff Report, p.6, Table 5, fn. 3).
 - The “Building Permit Data - Single-Family Residential” data in the Staff Report, August 20,2024 DTA Memo, Attachment 1, p. 6, show approximately 22 FY 2023 single-family projects, which at approximately \$66,000 per project, would yield approximately \$1,450,000 in impact fee revenue, but the [“City of Palo Alto Development Impact Fee Report for Period Ending June 30, 2023”](#) (FY 2023 Development Impact Fee Report)

- pp. 3-4, shows only about \$495,000 in parks (\$439,967), community center (“\$34,559), and library (\$20,398) impact fees collected.
- Palo Alto’s “PROPOSED CAPITAL BUDGET, FISCAL YEAR 2023,” believed to be only an interim document, showed a proposed total of \$2,300,000 to be transferred from community center, library, and parks development impact fee funds to a “Roth Building Rehabilitation Phase 1” project in FY 2023. It is unclear whether any substantial portion of such amounts were actually spent on that project or, if so, when such expenditures were made. In particular, the FY 2023 Development Impact Fee Report, p. 9, shows actual FY 2023 expenditures of about \$725,000 from parks impact fees for projects at Boulware Park and Rinconada Park, and for Park Restroom Installation, without any expenditures from community center or library impact fees in FY 2023. But that report does not show the types of housing that were taxed, nor the extent of such housing taxes by type of housing, corresponding to such expenditures.
 - What is needed every fiscal year is a clear and concise summary of fiscal inputs and fiscal outputs with respect to the parks, community center, and library impact fees. One should be able to know, by fiscal year, (a) what types of housing are being subjected to impact fees, (b) what amounts of impact fees, by type of housing and by type of impact fee, are being paid for each fiscal year, and (c) how those fees are ultimately being spent, whether in a current or future fiscal year. Transfers of money between different, specified funds to specific projects, capital spending plan adjustments during the course of a year, and withdrawals from and additions to reserve accounts all make it difficult for the public to understand how, and to what extent, revenues from residential housing impact fees are being raised, and how those revenues are ultimately being spent.
 - Particularly because of the City’s express admission to the HCD that Palo Alto’s current, per-unit impact fees have “led to some inequitable results...,” Housing Element V6, p. 4-65, and particularly because the City has continued to charge impact fees for larger ADUs since that admission was first made — now several quarters ago — the City Council should provide refunds from the date that the City first acknowledged the problems with its current residential impact fee regime to those homeowners and others who have paid improperly large ADU impact fees. A revised report should detail the number of such projects, the amount of all such payments and estimates of the amount of such refunds.

Finally, to allow for reasonable public input in light of the HCD-approved Housing Element, the City Council should (a) direct the Planning and Transportation Commission to allow for public comment on these issues at its October 09, 2024 meeting, (b) direct City Staff to prepare a revised report, and (c) continue this matter to the City Council’s November 4, 2024 meeting.

Attachment

TO: Palo Alto City Council (City Council)
RE: Recommendations re Agenda Item #28, "PUBLIC HEARING: Adoption of Budget Ordinance for Fiscal Year 2025 [etc.]" and Comments re Staff Report [2406-3140](#) (Staff Report)
DATE: June 17, 2024
FROM: John Kelley

RECOMMENDATION

Because the likelihood of the City Council's modifying the FY2025 budget tonight is low, and because Palo Alto's impact fees are inequitable, irrational, and may fail to take account of a recent United States Supreme Court decision, the City Council should (a) thoroughly examine and revise the City's impact fees at its first or second meeting in August and (b) recalculate the fees charged to all applicants in recent years, providing refunds as appropriate.

DISCUSSION

Palo Alto's inequitable, irrational, and possibly improper impact fee regime should be suspended or quickly changed, and refunds should be granted.

Palo Alto's Housing Element acknowledges that the City's current, per-unit impact fees have "led to some inequitable results...."¹ It also notes that "Palo Alto's development impact fees/capacity fees are amongst the highest in the region for both single-family and multi-family home construction."² Some members of the City Council and City Staff appear to recognize that the current per-unit impact fee regime needs to be changed.³ Based upon the discussion at the City Council's April 15, 2024 meeting, it appears that City Staff anticipated presenting a new proposal to the City Council in May, 2024, but, for unknown reasons — likely because of other work being undertaken by members of City Staff — it appears that this did not occur. As a result, the proposed FY 2025 budget not only maintains the same, inequitable, per-unit impact fee regime, but it also increases those fees.⁴ This is an extremely unfortunate result.

What should be done about this problem? Given the City Council's vacation schedule and the City Staff's current workflows, it seems quite unlikely that the City Council will vote tonight to adopt a new, non-per-unit impact fee regime. Even that

¹ "[2023-2031 Housing Element, City of Palo Alto](#)," April 2024, Adopted, at 4-64.

² *Id.* at 4-2

³ See, e.g., "[Sp. City Council Meeting, Summary Minutes](#): 04/15/2024," at 11.

⁴ Staff Report, Attachment A, Ex. 5, at p. 7, and [Attachment A](#), Ex. 6, at pp. 1-2.

action, however, would be sub-optimal, because it ignores other significant problems with Palo Alto's current approach to impact fees.

In somewhat the same way that the City Council reacted to a judicial decision concerning the use of natural gas earlier this year, the City Council could temporarily suspend impact fees until this matter can be taken up after the City Council's vacation. That might be the most respectful approach, especially towards current applicants. But it, too, would be incomplete.

Whether or not the City Council temporarily suspends impact fees tonight, I strongly recommend a rapid and fulsome analysis of the multiple problems presented by the current impact fee regime.

- The current regime adversely affects not only ADUs, but also apartments, condominiums, and SB9 units (collectively, New Smaller Homes). All of these, generally smaller, homes are subjected to a "Palo Alto housing tax." For some homes, that housing tax is now approaching \$80,000. If Palo Alto is committed to building both more and more affordable housing, such draconian housing taxes must end.
- As to ADUs, as mentioned above and as discussed in the attached April 14, 2024 letter to the City Council, the current impact fee regime leads to particularly inequitable results.
- In addition, as to all New Smaller Homes when compared with single-family homes, inequity becomes irrationality. Under Palo Alto's current per-unit impact fee regime as applied to parcels with existing single-family homes, a property owner substantially adding to or completely scraping a 2,000 sf primary dwelling and replacing it with a 5,000 sf or larger primary dwelling will pay no impact fees at all, whereas the builder of ten 500 sf studios — having a total of 5,000 sf — might pay over \$500,000 in FY2025 for Park Impact Fees alone.
- Moreover, the United States Supreme Court held on April 12, 2024 that the Fifth Amendment's Takings Clause "does not distinguish between legislative and administrative land-use permit conditions."⁵ Since the United States Supreme Court vacated the judgment of the California Court of Appeal and remanded the case for further proceedings, it is not clear how emerging federal law affecting impact fees will develop. The City Council can and should, however, take notice of this decision.
- Finally, the problems with the "Palo Alto housing tax" have been known essentially since the current impact regime was put into place by a prior council a few years ago. Once a new, equitable, rational, and forward thinking approach to

⁵ *Sheetz v. County of El Dorado, California*, Syllabus (601 U. S. ____ (2024)) ([Slip Opinion](#), at p. 1).

impact fees has been adopted by the City Council — preferably at the first or second City Council meeting in August - all of the impact fees that have been charged since the current regime was established should be re-calculated, and the difference between the fees previously paid and those that would have been assessed under newly adopted rules should be refunded to applicants with interest.

Whether or not the City Council suspends the current impact fee regime before adopting the FY2025 budget, these issues deserve quick and thorough attention at the first or the second City Council meeting in August. At that meeting, besides adopting a new approach to impact fees, the City Council should refund the difference between the fees that applicants have paid in recent years under the current impact fee regime and the fees that would have been charged under a proper approach.

Attachment

TO: Palo Alto City Council (City Council) and Planning & Transportation Commission (PTC)
RE: Recommendations re Agenda Item #13, “Joint City Council and Planning and Transportation Commission Meeting to Adopt a Resolution Amending the Comprehensive Plan by Adopting a Revised 2023-31 Housing Element [etc.]” and Comments re Staff Report [2312-2450](#) (Staff Report)
DATE: April 14, 2024
FROM: John Kelley

RECOMMENDATION

City Staff have improved the prior version of the 2023-2031 Housing Element (Housing Element) in important ways, but the PTC and the City Council should direct City Staff to make further changes in the revised Housing Element prior to adopting it and delivering it to the California Department of Housing and Community Development (HCD).

DISCUSSION

1. ADUs Play a Crucial Role in the City’s Housing Element

The City relies heavily on accessory dwelling units (ADUs) in attempting to meet its RHNA. For example, when comparing the “ADUs” row with the “Total Unit Surplus” row in Table 3-27, “Adequacy of Residential Site Inventory,” of the revised draft “Palo Alto Housing Element 2023-2031 (Redlined),”¹ for both (a) the combination of the “Very Low-Income” and the “Low-Income” columns and (b) the “Moderate Income” column, one can see that the “ADUs” values exceed the “Total Unit Surplus” values. Thus, if the City fails to produce very low-income, low-income, and moderate-income ADUs to the extent predicted, much of the “buffer” may disappear, the City may fail to satisfy its RHNA. Accordingly, assessing the City’s constraints on ADU production is vital in analyzing the sufficiency of the Revised Redline Housing Element.

2. The City’s ADU Projections Still Ignore Important Constraints

The City relies on ABAG’s technical guidance for estimating the future distribution of ADUs by income category based on actual Palo Alto production figures from 2019-2021.² Yet the ABAG technical memo articulates its own limits: “ABAG conducted

¹ “Revised Redline Housing Element” or “RRHE,” <https://paloaltohousingelement.com/wp-content/uploads/2024/04/Palo-Alto-Housing-Element-1.pdf>, p. 3-72.

² <https://abag.ca.gov/sites/default/files/documents/2022-03/ADUs-Projections-Memo-final.pdf>, RRHE, p. 3-8.

an analysis of ADU affordability and concluded that *in most jurisdictions*, the following assumptions are generally applicable.”³ “Generally applicable,” however, does not necessarily mean “applicable in Palo Alto” (especially if one considers the “Palo Alto premium,” among other things). Thus, in assessing the RRHE, one must scrutinize the unique constraints that Palo Alto imposes on ADU production.⁴

A. Impact Fees

Since an earlier draft of the Housing Element was submitted to the HCD in 2022, the City Council again raised the impact fees imposed on 750+ sf ADUs.⁵ Today the FY2024 facial — essentially “MSRP,” because proportionality discounts apply to such ADUs — total of Community Center, general government, library, park, and public safety facilities fees for “Single Family” in Palo Alto totals \$76,385, more than \$3,000 greater than the base, \$72,562 figure discussed in the RRHE.⁶ Because Palo Alto changed both the categories used to calculate impact fees and the magnitude of the fees,⁷ their effects were not reflected in 2019-2021 baseline ADU production figures that the City has relied upon in its RHNA projections.⁸ Furthermore, as applied especially to ADUs,

³ <https://abag.ca.gov/sites/default/files/documents/2022-03/ADUs-Projections-Memo-final.pdf>, p. 1 (emphasis added).

⁴ Until recently, Palo Alto’s Tree Ordinance, PAMC Chapter 8.10, “TREE AND LANDSCAPE PRESERVATION AND MANAGEMENT,” https://codelibrary.amlegal.com/codes/paloalto/latest/paloalto_ca/0-0-0-65934#JD_Chapter8.10, was among the most important, Palo-Alto-specific constraints on ADU production. At the City Council meeting on April 1, 2024, the City Council considered a Staff Report incorporating an important finding from the City Attorney:

During passage of the tree ordinance updates in January, staff confirmed during the Council Questions that based on CAO analysis of PAMC Chapter 18.09, the updated Title 8 and applicable state law, *the tree ordinance would not apply to stand alone Table 1 ADU’s*.

Staff Report 2403-2809, <https://cityofpaloalto.primegov.com/meetings/ItemWithTemplateType?id=4688&meetingTemplateType=2&compiledMeetingDocumentId=9485>, p. 1 (emphasis added). (Since this statement was attributed to the City Attorney’s Office, it is assumed that the City will follow that guidance and no longer apply the Tree Ordinance to what are, in effect, statewide exemption ADUs.) Attachment A, the ordinance proposed by City Staff, was amended at the April 1, 2024 meeting. See the video of the April 1, 2024 meeting, <https://www.youtube.com/watch?v=s2PxduJHco>, beginning at approximately 6:06:59.

⁵ “ADOPTED MUNICIPAL FEE FISCAL YEAR SCHEDULE 2024,” “Impact & In-Lieu Fees,” “Development Impact Fees - Residential,” (FY2024 Fee Schedule) (<https://www.cityofpaloalto.org/files/assets/public/v/1/administrative-services/city-budgets/fy-2024-city-budget/adopted/fy24-muni-fee-book-final.pdf>), p. 65.

⁶ FY2024 Fee Schedule, p. 65, and RRHE p. 4-64. Please note: in the RRHE, a range of values is provided, “\$72,562 - \$302,362.” See pgs. 4-63 – 4-64 for a discussion of how the \$302,362 figure is calculated. The City acknowledges that such “larger projects involving detached single-family homes.....are rare....” RRHE p. 4-64. (Perhaps ADU impact fees could even exceed the “MSRP.”).

⁷ [Staff report for 4/20/2021 meeting](#), p. 8

⁸

<https://www.paloaltoonline.com/news/2021/04/15/palo-alto-hikes-development-impact-fees-for-first-time-in-20-years> Compare the figures on RRHE, p. 3-8.

the City's impact fee structure is (a) inequitable, for multiple reasons, only one of which is discussed in the RRHE, and (b) a significant impediment to production of ADUs, a point not addressed in the City's RRHE financial feasibility analysis. Pgs. 4-64 - 4-65.

The City itself acknowledges that the basic, per-unit fee architecture is inequitable, but it promises to make amends:

In accordance with state law, fees for ADUs are only charged on ADUs larger than 750 square feet, and are charged in proportion to the fee that are or would be assessed on the primary unit. Because Palo Alto has historically charged per-unit fees for residential development, this has led to some inequitable results, as the fees for an ADU will depend not only on the size of the ADU, but also on the size of the primary unit, with higher fees required under state law when the primary unit is smaller. To avoid this scenario, the City will implement Programs 3.1 and 3.5 to convert fees to a per square foot calculation.⁹

That is a step in the right direction but remains insufficient to correct past and continuing harms. This promise lacks a specific deadline, but Program 3.1 refers to December 2024. RRHE, p. 5-15. Still, that program omits some of the impact fees identified above, is not offered as a specific condition for present acceptance of the RRHE, and offers nothing to those previously saddled with inequitable housing impact fees to obtain permits for ADUs in Palo Alto. The City should:

- not submit a further revised Housing Element to the HCD until the current per-unit system is replaced;
- immediately place a moratorium on charging new impact fees for ADUs until such a new system is adopted; and, after its adoption,
- recalculate the impact fees for any ADU built after the revised fee schedule was first adopted in April, 2021, refunding the difference between the previously charged fees and those that would have been due under the new system to homeowners.

Even with such changes, however, the City would only be addressing one half of the inequities built into its current impact fee structure as applied to ADUs.

In the FY2024 Fee Schedule at p. 65, the phrases "Single Family" and "per unit" tell only a partial story. The City asserts that "the burden of housing costs is being more equitably distributed across project types," pg. 4-65, but the discussion in the "DEVELOPMENT IMPACT FEES AND IN-LIEU FEES" section, RRHE pgs. 4-63 – 4-65,

⁹ RRHE p. 4-64.

fails to make clear that, as currently implemented, “Single Family” and “per unit” essentially mean “brand new single-family on a vacant parcel.” This implicit meaning of the fee schedule language is noteworthy given the City’s observation that there is a “lack of vacant land in Palo Alto.” RRHE pgs. 4-64. It is inequitable to impose impact fees on ADUs that vary with the size of the primary dwelling on a parcel — such that a person with an 800 sf house might have to pay \$76,385 to build an 800 sf ADU, whereas a neighbor with a 3,200 sf house would only pay a quarter of such fees to build an identical 800 sf ADU. But a far more fundamental inequity becomes evident when one compares single-family homes and ADUs.

- Instead of building an 800 sf ADU, the hypothetical homeowner with an 800 sf house could instead add 2,400 sf to the house, but since there was a pre-existing home on the lot, Palo Alto would not currently charge \$76,385 in impact fees, nor indeed any of the park or other impact fees detailed above, on that home addition, even though it would be three times the size of the 800 sf ADU alternative.
- If the hypothetical neighbor, with a 3,200 sf house, had the capital and the desire, the neighbor might “scrape” the entire existing house, rebuild at or above grade 3,200 sf more luxuriously, and then add a basement, perhaps 2,400 sf in size, and, again, not pay any impact fees.

The City may “implement Program 3.1 *Fee Waivers & Adjustments*” before New Year’s Eve 2024, RRHE pgs. 4-65, but this does not appear to include a commitment to alter the fundamental discrimination in Palo Alto’s impact fee architecture as implemented: the City privileges substantial additions to and even complete “scrapes” of single-family homes, while seeking to shift the vast majority of all housing impact fees to new ADUs, apartments, condominiums, and townhomes. Palo Alto’s impact fees are, in essence, housing taxes on smaller, non-R-1 dwellings. Such taxes constrain ADU production.

As HCD has recognized,¹⁰ one of the merits of ADUs as a housing production strategy is their low costs. This “lower denominator” means that the impact fees charged by Palo Alto constitute an outsized percentage of costs for ADUs. As a corollary, the financial feasibility analysis offered by the City, RRHE pgs. 4-64 - 4-65, is not applicable to ADUs. Rather than building four dozen townhomes, a Palo Alto homeowner may only be seeking to build a single 800 sf ADU. Adding even tens of thousands of dollars to an ADU project may make it significantly less attractive to an individual homeowner, who generally would have lower access to capital than the developer of 48 townhomes. Even without reaching the full \$76,385 amount, many homeowners with smaller homes

¹⁰ “ACCESSORY DWELLING UNIT HANDBOOK UPDATED JULY 2022” (“HCD 2022 ADU Handbook”)(<https://www.hcd.ca.gov/sites/default/files/docs/policy-and-research/ADUHandbookUpdate.pdf>), p. 4.

will end up being charged \$25,000, \$30,000 or even more in “Planning Impact Fees” before they can receive a building permit for an ADU from the City. Not everyone in Palo Alto can put \$25,000 on a credit card or send an e-check for \$30,000 to the City. Thus the architecture of City’s housing impact fees — already heavily disadvantaging ADUs — further privileges more economically advantaged homeowners. The City’s financial feasibility tests will be cold comfort for many homeowners building ADUs.

The burden of the City’s impact fees on ADUs — whether \$25,000 or \$75,000 — will also affect the City’s ability to meet its RHNA, particularly for more affordable housing. This is especially true given the current interest rate environment. If one were able to obtain — which could be quite difficult — a 30-year fixed mortgage at 7% to build an ADU, \$30,000 in marginal fees paid to Palo Alto would translate into an approximately \$200 greater monthly payment.¹¹ \$200 per month translates into a sizable percentage of the 1- and even 2-person rents described in “TABLE 2-18 MAXIMUM AFFORDABLE HOUSING COSTS, SANTA CLARA COUNTY, 2021” for the “Extremely Low Income,” “Very Low Income,” “Low Income,” and even “Median Income rental limits. RRHE pg. 2-39. Thus the the City’s reliance on ADUs to meet its affordable housing goals is incoherent if not completely inconsistent:

- while relying on ADUs to provide a significant percentage of its more affordable units, and while knowing that any such tax will constitute a relatively larger proportion of project costs in comparison with, for example, R-1 developments, the City nonetheless taxes ADU production; and
- Program 3.1 does not appear to commit the City to correcting the taxation disparity between new smaller housing units — ADUs, apartments, etc. — and new additions to or “scrapes” of single-family homes.

Both the magnitude and the architecture of Palo Alto’s impact fees significantly constrain ADU production, particularly production of more affordable ADUs.

B. Utilities Policies

City of Palo Alto Utilities (CPAU) policies further constrain ADU production. While the UAC may take up this issue at some point in the future, at present the City follows what is, in essence, a “one-parcel, one service” policy in R-1 neighborhoods. This means that, for example, electrical, water, and sewer services for a primary

¹¹

https://www.google.com/search?q=mortgage+calculator&oq=mortga&gs_lcrp=EgZjaHJvbWUqDQgAEAA YgwEYsQMYgAQyDQgAEAA YgwEYsQMYgAQyDQgBEAA YgwEYsQMYgAQyBggCEEUYPDIGCAMQR Rg8MgYIBBBFGD0yBggFEEUYPDIGCAYQRRhBMgYIBxBFGEGoAgCwAgA&sourceid=chrome&ie=UTF -8

dwelling and an ADU (or JADU) on the same lot will be provided and billed under one CPAU account. If a homeowner is seeking to build and rent an ADU (or JADU), this can cause several types of problems.

- Tiering problems. If a utility's prices are tiered based on consumption (for example, higher per unit rates above one or more thresholds), then two households on a single account will be billed at a marginally higher rate than they would be billed on two separate accounts.
- Overhead and collections problems. Even with sub-metering equipment, a homeowner renting an ADU will be left with the tasks of calculating charges, billing, and receiving payment.
- Fundamental capital cost problems, especially with electrical services. Many existing single-family homes in Palo Alto have existing 100A or 200A electrical services. Adding even an 800 sf ADU may, based on the normal electrical load calculation methods followed by CPAU at present, and especially if a homeowner is seeking to build an all-electric ADU, result in approximately 100A (or more) of additional electrical load. While other techniques may be used, if one simply seeks to increase one's electrical service capacity, present CPAU forms and policies can result in the need for an application to increase the existing electrical service to 400A, even though some of this capacity is not necessarily needed for the ADU. Such an electrical upgrade, including both the fees charged by CPAU and those charged by a contractor, can sometimes cost \$10,000 or more.
- "Loser lottery." That first \$10,000 cost may not be the biggest cost. CPAU may, in addition, determine that there is not sufficient capacity in its local distribution system for a new 400A service, in which case an ADU applicant may have "won" a "loser lottery": CPAU may determine that, because the ADU would exhaust local distribution capacity, the ADU applicant should bear the cost of, for example, upgrading a transformer, or, sometimes, even having also to place a large pedestal for new CPAU-owned electrical equipment in the applicant's front yard.¹² The "winners" of such a "loser lottery" might have to pay tens of thousands of additional dollars to CPAU.

Returning to the prior mortgage cost analysis, all of these costs might add another \$70, \$140, \$210, or more in monthly costs to an ADU project, further undermining its potential to help the City meet its housing affordability goals.

Other policies could and should be adopted by the City.

¹² Requiring such payments and siting equipment on a homeowner's land as conditions for obtaining a building permit may be quite improper, e.g., as requiring a "public benefit" from a building permit applicant.

- CPAU could and should give homeowners building ADUs the option — as determined solely by the homeowner, and at the homeowner’s expense — to build a new ADU (or JADU) with its own utilities, particularly electrical and water utilities. The homeowner should decide if such capital investments make sense.
- CPAU could and should bear the costs of maintaining its own distribution capacity, an issue that will probably return to the City Council in other contexts (e.g., future deliberations regarding S/CAP and electrical infrastructure).
- CPAU could and should move more quickly in accepting, working with, and even supporting alternative means of calculating electrical loads under the NEC.

With such changes, the City would begin to eliminate some of the most important constraints on ADU, and especially affordable ADU, housing production resulting from current CPAU policies.

C. Permitting Policies

Government Code sub-section 66314(a) allows a local agency to designate areas in which ADUs may be permitted based on “on the adequacy of water and sewer services and the impact of accessory dwelling units on traffic flow and public safety.”¹³ Government Code sub-section 66317(c) provides: “No local ordinance, policy, or regulation, other than an accessory dwelling unit ordinance consistent with this article shall be the basis for the delay or denial of a building permit or a use permit under this section.”¹⁴

Despite these and other limits on which types of considerations a local agency may consider in reviewing an ADU permit application ministerially, the City routinely routes ADU permit applications to multiple departments whose reviews are not specifically authorized under the California statute, including, Urban Forestry, Electrical Utilities, and the gas portion of WGW Utilities. Individualized reviews of ADU permit applications by such departments, particularly involving non-objective standards, frustrate the ministerial ADU permit application process. The City’s routinely subjecting

¹³

https://leginfo.ca.gov/faces/codes_displayText.xhtml?lawCode=GOV&division=1.&title=7.&part=&chapter=13.&article=2.

(formerly Government Code sub-section 65852.2(a)(1)(A), see

<https://codes.findlaw.com/ca/government-code/gov-sect-65852-2/https://codes.findlaw.com/ca/government-code/gov-sect-65852-2/>).

¹⁴

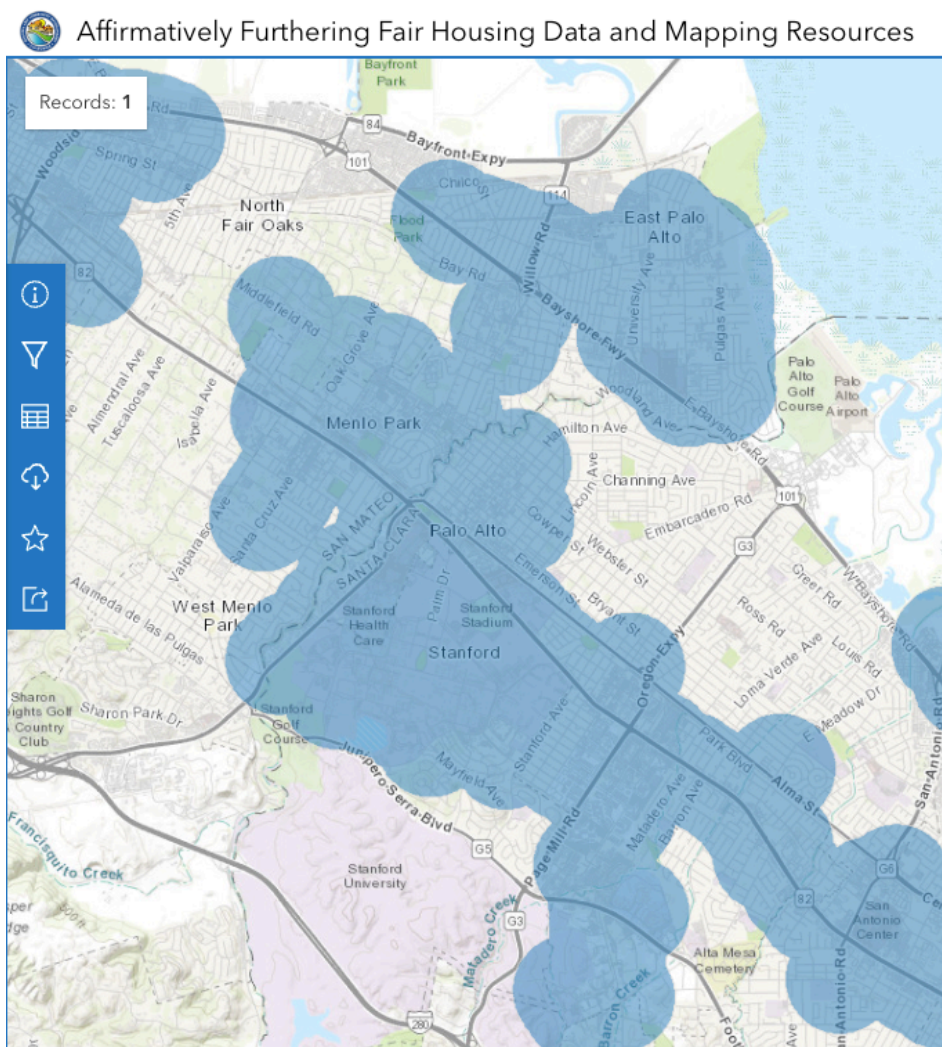
https://leginfo.ca.gov/faces/codes_displayText.xhtml?lawCode=GOV&division=1.&title=7.&part=&chapter=13.&article=2. (formerly Government Code sub-section 65852.2(a)(7), see

<https://codes.findlaw.com/ca/government-code/gov-sect-65852-2/https://codes.findlaw.com/ca/government-code/gov-sect-65852-2/>).

ADU applications to such reviews is another way in which it constrains ADU production, delays ADU permit issuance, and increases costs to those seeking to build ADUs.

D. Disavowing HCD's AFFH Tools

The HCD has provided tools for determining whether certain types of ADUs are allowed in particular areas. The “Affirmatively Furthering Fair Housing Data and Mapping Resources” is an example of one such tool.¹⁵ Using it, one can identify, for example, “High Quality Transit Stop Areas” within Palo Alto:¹⁶



¹⁵ <https://affh-data-and-mapping-resources-v-2-0-cahcd.hub.arcgis.com/>

¹⁶

https://affh-data-and-mapping-resources-v-2-0-cahcd.hub.arcgis.com/datasets/636e3f917b3445929f4aa0647afc4085_2/explore?location=37.436345%2C-122.134573%2C12.94

Such a map should allow one, before filing an ADU building permit application, to determine with precision whether one can build, for example, an 18' detached ADU on one's property. See_PAMC 18.09.030, Table 1, fn. 5.¹⁷ Despite the availability of such tools, Palo Alto appears not to recognize their accuracy, and appears to base its determination of such areas based on its own compilation of data, which may well be inadequate and incomplete.

Failing to acknowledge and accept the legitimacy of such HCD-provided AFFH tools is another significant constraint on ADU production, because it makes it more difficult, more expensive, and more time-consuming to determine whether one can build the type of ADU that one might seek to build in Palo Alto; even more unfortunately, it can result in an incorrect determination of whether a particular design is permissible.

3. Compounding Effects and Cumulative Financial Metrics

Extremely high and inequitable impact fees, costly utilities policies, onerous permitting practices, and disavowal of recognized AFFH tools are all, when considered individually, significant constraints on ADU production and especially on production of more affordable ADUs in Palo Alto. Considering them collectively compounds and multiplies deleterious effects, further reducing the likelihood of the RRHE being sufficient to meet Palo Alto's RHNA mandates.

- Regulatory uncertainty, such as that caused by the City's failure to acknowledge HCD-provided AFFH tools may keep an ADU project from ever commencing. Knowing that friends or neighbors in other parts of Palo Alto can build 18' detached ADUs (e.g., over an existing detached garage) may set an expectation for prospective ADU applicants that cannot be verified at the outset of a project.
- Prospective ADU applicants that live in smaller homes and that may also be less capital advantaged may be dissuaded from building larger ADUs when they can spend the money in better ways simply by adding onto their existing houses without incurring enormous impact fees. Why let the City charge \$50,000 or \$75,000 for an 800 sf ADU when the same overall budget might support an extra bedrooms or even more in a 900 sf or larger addition?
- How much will it actually cost, over the lifetime of an ADU, to pay higher marginal electrical and water service rates with single accounts for both primary dwellings and ADUs? Who will bear that financial risk?
- Would one decide not to build an all-electric ADU or even drop a project if CPAU failed to pay the costs for upgrading a transformer in its distribution plant?

¹⁷ https://codelibrary.amlegal.com/codes/paloalto/latest/paloalto_ca/0-0-0-76751

- Who, indeed, would ever want to be the grand-prize “winner” in a “loser lottery,” having to pay \$10,000, \$20,000, or even more to install a 400A electrical service, with the special bonus of housing a CPAU transformer in one’s front yard?
- Why should there be any review by Urban Forestry, Electrical Utilities or gas utilities of 800 sf or smaller ADUs? Why are such reviewing departments in Palo Alto also sometimes the very last to approve an ADU application, delaying what is supposed to be a maximum 60-day, completely objective, and ascertainable-in-advance, ministerial review process?
- Obtaining an ADU building permit from any local agency in California should be quick, easy, and inexpensive. Those are not the adjectives that many homeowners who have built, or who would like to build, ADUs in Palo Alto would use to describe the City’s permitting processes. Instead, as a result of other City policies and practices, those seeking to build ADUs and other residential dwellings often come face-to-face with the “Palo Alto Premium,” the implicit surcharge that contractors and others may impose for working in Palo Alto.

All of these effects, especially when considered in combination, take their cumulative toll, particularly on production of more affordable ADUs in Palo Alto. Yet the RRHE assumes, based on ABAG’s conclusions about circumstances in “most jurisdictions,”¹⁸ that over 300 ADUs will be built in Palo Alto over the next several years, apparently for rental at the “Extremely Low Income,” “Very Low Income,” and “Low Income” prices described in Table 2-18. RRHE, pg. 2-39.

In the “AFFORDABILITY” section of the RRHE, the City seems almost to concede that this is fanciful.

When comparing the home prices and rents shown earlier in Figure 2-17, Figure 2-18, and Table 2-16 with the maximum affordable housing costs presented in Table 2-18 below, it is evident that extremely low-, very low- and low-income households in Palo Alto have almost no affordable housing options without substantial subsidies.

RRHE, pg. 2-39. How is the City intending to provide such subsidies for ADUs?

While Section 2.6 of the RRHE, “HOUSING STOCK CHARACTERISTICS,” discusses, among other things, means of addressing expiring Section 8 project-based subsidies, RRHE, pgs. 2-83 - 2-88, it is unclear whether, and if so how, these or other discussions of potential subsidies would or could apply to the 300+ ADUs the RRHE assumes would be available at extremely low-, very low- and low-income rental prices.

¹⁸ <https://abag.ca.gov/sites/default/files/documents/2022-03/ADUs-Projections-Memo-final.pdf>, p. 1.

What is known is that the combination of extremely high and inequitable impact fees, costly utilities policies, onerous permitting practices, and disavowal of recognized AFFH tools operates as an anti-subsidy, as a housing tax, especially on ADUs.

The City does not appear to have offered an ADU-specific financial analysis of such constraints. What metrics might one use to assess the City's policies and practices on ADU housing production? At least two come to mind.

One standard has a proven track record of success at the state level. During those parts of a fiscal year when its funding has not been fully allocated, and for eligible recipients, the maximum \$40,000 grants offered by CalHFA appear to have been successful in stimulating ADU production.

CalHFA's ADU Grant Program has already created more housing units in California by providing grants up to \$40,000 to reimburse pre-development and non-recurring closing costs associated with the construction of an ADU. Pre-development costs include site prep, architectural designs, permits, soil tests, impact fees, property surveys, and energy reports.¹⁹

Under the 2023-24 state budget, which provided \$25 million for the project, there appears to have been “high demand”²⁰ for such grants. As a first approximation, and certainly one that would appear to be more relevant to ADU construction than a survey of four dozen townhomes, a \$40,000 marginal cost might be more than sufficient to have negative implications for ADU production.

A second method of calculation might be based upon the Santa Clara County ADU “Accessory Dwelling Unit Calculator.”²¹ Assuming that one were seeking to build a “0 Bed / 1 Bath / 0 / 400 sqft” studio in Palo Alto, the calculator projected \$184-224K in development costs, an estimated monthly rent of \$1,600 - \$2,000, monthly expenses of \$1,500 - \$1,900, based upon a capital structure of a \$60,000 cash investment and a \$144,000 loan with a 20 year term and an 8% interest rate, yielding an estimated monthly mortgage payment of \$1,194. Since the estimated monthly rent was quite comparable to the estimated monthly expenditures with this capital structure, it appears that most of the economic benefit was projected to be realized as an increase in property value. “It is estimated that your ADU will increase your home value by \$214,000.”²² But using \$60,000 in cash, and leveraging it with a \$144,000 mortgage — even if one could obtain such a mortgage — to produce an increase in value of

¹⁹ <https://www.calhfa.ca.gov/adu/index.htm>

²⁰ <https://www.calhfa.ca.gov/homeownership/bulletins/2023/2023-12.pdf>

²¹ <https://citiesassociation.org/documents/santa-clara-county-adu-calculator/>

²² <https://santaclaracounty.aducalculator.org/>

\$214,000 in a relatively illiquid asset with relatively high sales transaction costs would appear, on its face, to be only modestly attractive as an investment opportunity when 10-year Treasury bonds are yielding, at least at this time, over 4.5%.²³ As a result, one might expect an economically motivated ADU applicant to strive to increase rents higher, potentially to levels above what the City has contemplated in Table 2-18.

There is a substantial chance that Palo Alto's constraints on ADU production will cause the City to fail to meet its projected targets for extremely low-, very low- and low-income ADUs. As a result, the City's "Buffer above Remaining RHNA After Credits," RRHE, pg. 3-72, for those categories of affordable housing units may be lost.

In addition to the policy changes discussed above — eliminating or greatly reducing impact fees on ADUs; returning previously inequitably levied impact fees to homeowners; allowing, at a homeowner's option and expense, for separate electrical and water utilities services for ADUs; ending Urban Forestry, Electrical Utilities, and WGW gas-related departmental reviews; and accepting the results of HCD's AFFH tools — this analysis points towards the types of policy interventions to which the City should commit itself if it truly intends to rely upon ADUs as an important source of extremely low-, very low- and low-income housing during the current RHNA cycle. It could and should:

- replicate the maximum \$40,000 grants offered by CalHFA, perhaps in cooperation with CalHFA itself.
- offer qualifying ADU applicants, perhaps using the same income and other qualifications established by CalHFA, to provide, e.g., \$200,000 - \$300,000 loans at the City's cost of capital to those applicants willing to offer rentals at federally approved rates for a period of 10 years with "on-bill payments," perhaps through the CPAU's own billing system; and
- immediately implement AB 1033: "Accessory dwelling units, also referred to as ADUs and "granny flats," have been available in California only as rentals. But a new law, [Assembly Bill 1033](#), is giving Californians the opportunity to buy and sell them as condominiums," creating an important innovation to foster actual ownership of smaller homes in Palo Alto.

Palo Alto has the capability, the credit rating, and the spirit of innovation to provide capital and new forms of ownership for more affordable housing in our community. The City can augment ADU production, especially of more affordable ADUs, should the City Council demonstrate leadership and commitment to such goals.

²³ <https://www.bloomberg.com/markets/rates-bonds/government-bonds/us>