

Strategies for Fiscally Sustainable Infill Housing



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Cover Photo

Little Italy, San Diego, from Greenbelt Alliance

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Introduction

Passed in 2008, new state legislation (Senate Bill 375) now requires every major region within California to reduce statewide greenhouse gas emissions by accommodating new growth through infill urban development. A growing number of California cities want to comply with this new bill and promote thriving, infill development with multi-family housing affordable to families at a range of incomes.

The benefits of walkable, infill communities are many and well-documented – from greenhouse gas reduction to resource conservation to improved community health. However, in order to achieve the goal of more infill homes, a city's costs and revenues need to match up. Cities today are faced with a crippling economic recession that is forcing municipalities to drastically cut back on the public services – such as parks, libraries, police, and fire – that make these communities such great places to live. Since property tax rates were capped with the passage of Proposition 13 in 1978, revenues from residential land uses have not increased at pace with the rising costs of both infrastructure needs and public services in California. Cities are reticent to accommodate California's growing population within their borders without new revenue sources. Simply put, cities need a model for new housing development that is both environmentally sustainable and fiscally sustainable.

This report attempts to help infill housing advocates and city staff better understand the relationship between a city's fiscal health and infill housing development. It is divided into three parts. Part I provides an introduction to city general revenues and expenses associated with infill housing development. Part II describes strategies that California cities can use to raise additional revenues from housing development. Finally, Part III looks specifically at the City of San Jose as a case study of how a city may promote fiscally sustainable infill housing development.

The primary focus of this report is on strategies that cities can implement to generate net new revenues out of new multifamily infill housing development. Because of this narrow focus, many other important areas of investigation are left out of this report, including: state-level strategies to generate new revenues for cities (such as amending or repealing Proposition 13); cost reduction strategies (such as reducing the health care costs for municipal workers); revenue reallocation strategies (such as tax-increment financing); or new revenue sources from non-residential development (such as business license fees). All of these topics certainly play an important role in the overall fiscal health of a city, but they are beyond the scope of this report.



Infill homes.

Photo credit: Greenbelt Alliance

Part I: A Primer on Fiscally Sustainable Infill

This section is designed to help infill housing advocates understand the basic mechanics of how cities pay for infrastructure and public services – two essential parts of building a livable community. It's important to remember that this sort of fiscal analysis of housing only focuses on one aspect of the development. Obviously, other factors such as safety, affordability, and environmental sustainability ought to be considered when determining what sort of housing development is right for a community.

What you should take away from reading this primer is:

Infill homes usually costs less per unit than low-density greenfield housing for both infrastructure and most public

services. Most of the recent research shows that on a per unit basis, infill costs less than sprawl.

However, revenues from infill homes do not always cover all the costs. Property taxes are one of the primary revenues that cities receive from housing, but because of California's highly restrictive property tax laws, residential development generally does not generate enough revenues to offset their costs. So even though infill costs less per unit than sprawl, it generates less property tax revenues per unit, as well.

Oftentimes, planners and advocates do not fully understand what the costs and revenues are for infill housing development. The common perception in many

A Note on the Research

Academic research on the relationship between compact development and cities' costs for infrastructure and public services ranges widely in both their methodology and results. Most of the studies use aggregate data at the county level, which masks many of the cost efficiencies specific to infill compact development discussed in this report. Studies that use site-specific analysis in general do find compact development to have lower costs. Some of the most commonly cited studies are discussed below.

Studies by Helen F. Ladd and John Yinger in the early 1990s show that at the county level, the cost of infrastructure goes down with density, but public services cost per capita increase with increased density and city size. This finding was supported by a 2008 study by Randall G. Holcombe and DeEdra W. Williams that shows that infrastructure costs decrease as density increases, but public service per capita costs increase as density increases in cities of more than 500,000 people. However, both of these studies used average density across entire counties, which masks many of the location-based cost efficiencies of compact development.

John I. Carruthers and Godmunder F. Ulfarsson also used county-level data in their studies, but segregated urbanized and rural land within the county to create a finer grain analysis. Their research shows that all public services except sewage go down in per capita costs as density increases. They note that the lower cost for sewage in rural areas is likely due to the use of septic tanks, which is not feasible in urbanized areas. Robert Burchell et al. have also recently conducted a nation-wide study showing that while both sprawl and compact residential development will incur deficits under the status quo revenue generating policies, compact development's deficit is on average 10 percent less than sprawl, though in California they found no difference in cost between compact and sprawl development.

Learn More:

Burchall, Robert W., Anthony Downs, Barbara McCann, and Sahan Mukherji. 2005. *Sprawl Costs: Economic Impact of Unchecked Development*. Washington: Earth Island Press.

Carruthers, John I. and Gudmunder F. Ulfarsson. "Urban Sprawl and the Cost of Public Services." *Environment and Planning: Planning and Design*. 2003 30:503-522.

Holcombe, Randall G. and DeEdra W. Williams. "The Impact of Population Density on Municipal Government Expenditures." *Public Finance Review*. 2008 36:359.

Ladd, Helen F. and John Yinger. 1991. *America's Ailing Cities: Fiscal Health and the Design of Urban Policy*. John Hopkins University Press.

California cities is that housing will always be a fiscal loss for cities, and doing a full fiscal analysis will only increase opposition. However, it is important that infill housing advocates understand these fiscal issues so that acceptable solutions can be worked out beforehand.

In general, cities have two costs associated with housing: (1) one-time infrastructure and capital costs; and (2) ongoing public services (ie. police, fire, parks, and libraries) and infrastructure maintenance. This report will discuss both, but mostly focuses on a city's ongoing costs.

Cities also have a range of revenue sources, which can be roughly divided into two groups: (1) unrestricted, or general, revenues, and (2) restricted revenues. Unrestricted revenues go into a city's general fund and can be spent at the discretion of the city council. Restricted revenues can only be used to pay for specific things.

Not all cities provide the same services, or collect the same revenues. In California, roughly one quarter of cities are full-service cities, meaning that they provide all the common public services to their residents (police, fire, libraries, and parks). Many cities are partial-service cities, with some services such as fire provided through special districts and not by the city itself.¹ Revenues can also vary widely. For example, if a housing development is in a Redevelopment Area, then a significant portion of property tax revenues get diverted to the Redevelopment Agency. While this grants the Redevelopment Agency the ability to use this money on important things like affordable housing and new infrastructure, it can also mean less money for public services.

To complicate issues further, the costs of most services are usually calculated per capita, while the revenues are generated on a per unit basis. For example, many cities establish a parks requirement based on a number of acres per 1,000 residents. However, property taxes are collected based on the assessed value of the property, regardless of the number of residents.

Finally, there is ongoing disagreement about how to divide costs and revenues by land use. For example, sales taxes are an important revenue source for cities, which comes almost exclusively from commercial land uses like stores and shopping malls. However, stores need people living nearby who shop there in order to sell anything – which suggests that at least a portion of sales tax revenues should be attributed to residential uses. Cities will oftentimes hire consultants to determine how much their residents are spending on taxable goods in their city and develop a formula for allocating revenues accordingly.

Even with all this variation between and within cities, it is helpful to understand a city's basic balance sheet when it comes to housing. Below is a more detailed discussion of both the costs and revenues from infill development.

Tip: Reducing Infrastructure Costs

Transportation Many cities use an out-dated Level of Service traffic modeling analysis during the environmental review process of development that unfairly requires new development to look at local automobile traffic impacts, but not other modes of transportation or regional impacts. This oftentimes means that cities or developers must pay for costly road widenings in dense urban areas. Cities can go a long way in reducing this infrastructure cost by updating their model for analyzing traffic impacts to take into account pedestrians, bicycles, and public transit options, as well as regional traffic impacts.

Sewage and Water Many cities create agreements with developers in which the developer build sewage and water lines for a development, while the city is responsible for operating and maintaining them. While this can lead to cost savings because of timing efficiencies, the developer may choose to install a system that has the cheapest capital costs, but may be expensive to operate and maintain over time. If developers opt to build the infrastructure themselves, then it is important for the city to have stringent requirements that ensure operations and maintenance costs are manageable over time.

Parks City park requirements can be costly for an infill developer to fulfill because of the high cost of land in infill areas. City zoning regulations allowing rooftop open spaces or joint use agreements with nearby schools can help reduce the cost of building and operating parks while still providing recreational facilities for residents.

Costs of Infill Housing

A city's costs associated with building more housing are twofold. First, there are the initial costs of building or upgrading the infrastructure to serve the new housing; this may include building new roads, upgrading sewage and water capacity in the area, and building new facilities. Second, cities pay for many of the ongoing public services for the residents in the area, including police, fire, parks, and libraries. These ongoing costs also include operations and maintenance for the roads, sewage, and other infrastructure.

Infill housing can take advantage of both excess capacity in existing infrastructure and locational efficiencies to lower both initial and ongoing costs to cities. Below is an itemized description of infrastructure and service costs for a full service city and how infill can save money for cities, compared to single-family greenfield development.

Infrastructure costs

Transportation Road infrastructure per unit is on average much cheaper for infill compared to greenfield; there are simply less roads to be built per unit. Infill can incur significant transportation infrastructure costs if the city requires excessive traffic mitigation measures. See sidebar on “Reducing Infrastructure Costs” for more information.

Sewage and Water Sewage and water infrastructure per unit are usually cheaper in infill development because the infrastructure in place has excess capacity.² The costs of sewage and water both increase rapidly in sprawl development, and particularly where new development leap-frogs over existing agricultural or undeveloped land. Sewage pipes need either a constant downhill slope to the treatment facility or pumps to move the sewage. A constant slope becomes harder and possibly impossible to achieve over long distances, and pumps can be costly to maintain over time. Providing water over long distances also becomes costly, as pumps are needed to maintain adequate water pressure.³

Utilities Where electrical, phone, and internet lines have excess capacity in urban neighborhoods, the cost of utilities infrastructure for infill development is minimal. For new greenfield development, the cost increases with distance from existing trunk lines, particularly if the cables must be undergrounded.⁴

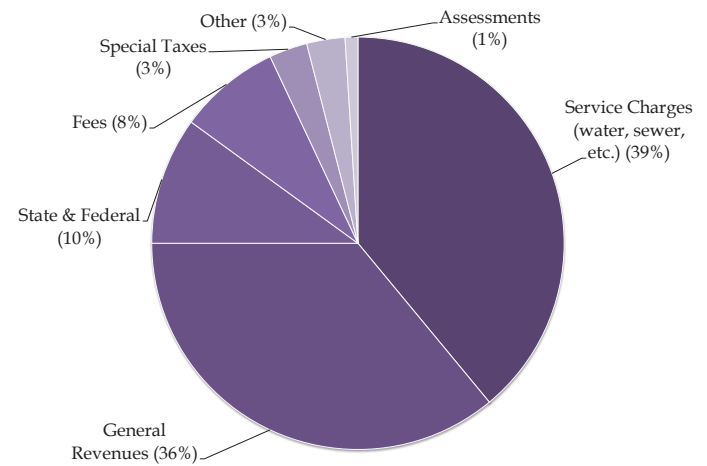
Capital Costs for Services The public services listed below often have up-front capital costs associated with them. Police and fire need stations and equipment; Parks and libraries require physical space or structures before operations can begin. These costs can vary significantly based on the capacity of existing facilities and how far they are from the new development.

Cost of public services

Police Services As new development is built, police departments must hire additional police officers and patrol cars for new beats. When density increases, hard costs such as patrol cars and gasoline decrease on a per capita level. While some argue that more police officers will be needed because crime rates go up in denser areas, there is more credible evidence that police costs per capita actually decrease with density because a police officer is able to cover more residents in a single beat.⁵

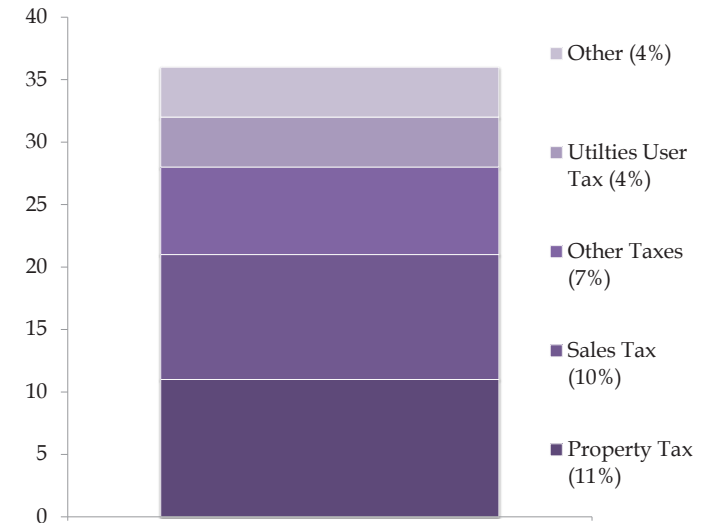
Fire Protection Services With fire protection services, response time is a key factor. Thus, if a sprawl development is built far from existing services, a new station may be required, adding significant costs. By the same logic, if infill developments are particularly tall, firemen may need special equipment to safely and quickly access them in the event of a fire. However, once that equipment has been purchased to service one building in a neighborhood, additional buildings at that height can be

Figure 1. Typical City Revenue Sources



Source: Michael Coleman. *A Primer on California City Finance*. League of California Cities, 2005.

Figure 2. Breakdown of General Revenues Sources



Source: Michael Coleman. *A Primer on California City Finance*. League of California Cities, 2005.

built nearby with minimal additional costs.

Parks and Libraries Operations and maintenance of parks and libraries can be a relatively small but significant cost that the city must pay for with scarce general revenues. Maintenance costs for parks are often lower when they are located near the service center, which is often near the city center. Most libraries have excess capacity and benefit from maximizing the number of residents nearby.

General Government and Planning These costs include everything needed to make a city run administratively, from planning and permitting to the City Manager’s office.

Infrastructure Operations and Maintenance The cost of operating and maintaining infrastructure over time varies considerably by neighborhood and by project site.

These costs are often lower for infill development simply because as densities increase, the cost of operations and maintenance per linear foot of infrastructure is spread over more residents.

Revenues from Infill Housing

Cities have two primary sources to pay for new infrastructure and increased demand for public services. First, cities can pay with general (or unrestricted) revenues. These revenue sources include automatic revenues such as property taxes and sales taxes, as well as additional taxes cities can choose to levy, such as Transit Occupancy Taxes (TOTs). For the average California city, general revenues make up 36 percent of a city's overall revenues.

In addition, cities can pay using targeted revenue sources, such as a traffic mitigation fee to pay for widening roads or a special assessment district to pay for parks maintenance. These additional revenue sources will be discussed in Part II of this report. Finally, it's important to note that the ongoing costs of many utilities are paid for through service charges, such as water, sewage, waste removal, etc., which will not be discussed here.

This section will discuss the general revenue sources cities can use to pay for infrastructure and public services, and how infill development affects these revenues. For a more general discussion on city revenues, an essential resource is "A Primer on California City Finance" available through the League of California Cities on their website.

Automatic general revenue sources

The first three general revenue sources discussed here – property taxes, sales taxes, and vehicle license fee – generate revenues for cities automatically. This means that a certain portion of these state-collected revenues are automatically returned to the city through a pre-established formula.

Property Tax Of all the basic general revenue sources, property taxes are the only ones directly generated by residential development. After Proposition 13 was passed in 1978, property tax was locked in at 1 percent of property value, with a maximum increase of 2 percent a year. Property tax gets reassessed whenever a property changes ownership or when major improvements are done on the land.⁶ While infill, compact development creates more property tax revenue per acre than low-density housing, it oftentimes generates less property tax revenue per unit or per capita due to the lower assessed value of each individual unit.⁷ Property taxes go first to the state, which uses a formula to determine how much of it goes to school districts, the county, and city general revenues. On average, cities receive 21 percent of property tax revenues in non-redevelopment areas. Property tax makes up 11 percent of a city's general revenues. Even though property taxes are levied on all properties, many commercial and

office building owners have found ways to minimize property tax increases on their properties by avoiding changes in ownership. Because of this, the residential share of property tax revenues increased from 50 percent to 64 percent in the last 30 years as the share from commercial properties has declined.⁸

Sales Tax Since Proposition 13, sales tax has increasingly become the most important source of revenue for many cities. On average, sales tax revenues are 10 percent of all revenues for cities. This has led to a fiscalization of land use as commercial developments have become a vital source of sales tax revenues for cities. Cities have a financial incentive to prioritize retail or commercial uses over residential or other uses that generate less sales tax revenue.⁹ Infill development can have two positive impacts on sales tax revenues: first, infill is often mixed-use, with sales-tax generating ground floor retail. Second, higher density means more residents who are likely to shop at stores in the city, boosting sales. Economic consultants can analyze a city's demographics and retail profile to determine how much new residents would contribute to this tax base.

Vehicle License Fee Cities receive the revenues from license fees of vehicles registered in their boundaries. In 2004, the state reduced the rate of the Vehicle License Fee (VLF) from 2 percent to 0.65 percent, and made up for the revenue loss to cities by backfilling it with additional property tax revenues to cities.¹⁰ Because of this, VLFs are now a small sliver of a city's revenues.

Additional general revenue sources

Below are some of the most common additional general revenue sources for cities. These revenues require additional action before they can be collected.

Utility Users Tax Cities are allowed to levy a Utility Users Tax (UUT) on a number of utilities, including gas, electric, water, and more. The tax can be approved by a city as either a special tax or a general tax to pay for city services. The tax is on average about 5 percent of a household's utility costs, and is included in the utilities bill. Nearly half of all households in California pay a UUT. Infill units often use less resources, and therefore pay less of the UUT than other units that consume a greater amount of resources.

Other Taxes and Fees Over three quarters of California cities levy a Transit Occupancy Tax on visitors who stay in the city. Because this is a revenue source tied to a specific land use (hotels and other lodging facilities), it has also led to a fiscalization of land use.¹¹ When infill developments include hotels, significant new revenues for the city may be generated. Business License Taxes are levied by most of California's major cities and provide an important source of general revenues, but infill housing development has a minimal impact on this revenue source unless the development also includes office space.

Conclusion – Adding it all up

So how well do these costs and revenues add up in an average Californian city? The table below is an example that shows a cost/revenue analysis for single family greenfield development and higher-density infill housing in a hypothetical city. The numbers are loosely based on similar analyses done by Michael Coleman. This is for illustrative purposes only to show how a cost/revenue analysis of housing development might look, and is not meant to apply to any particular city.

Though both the single family and multi-family development scenarios show a negative net impact, it's important to note that the single family scenario costs the city more per unit than the higher-density development. This is generally true, and can be explained in part by all the reasons discussed above: higher density infill housing can take advantage of locational efficiencies that lower costs for cities.

This example does not mean that infill development will never be able to pay for itself; it does mean that in some circumstances, additional revenues are needed in order to make infill housing fiscally sustainable for cities. In Part II, we'll talk about what these additional revenues might be. For a more specific analysis, see the case study on San Jose in Part III of this report.



Infill homes.

Photo credit: Greenbelt Alliance

Table 1. Example of Cost and Revenue Analysis for a City

	Single Family	Multi Family
ASSUMPTIONS		
Density (Gross)	4	20
Acres	5	5
Total Residential Units	20	100
Median Cost per Unit	\$500,000	\$250,000
Property Value	\$10,000,000	\$25,000,000
Average Property Tax Revenue to Cities	0.21 %	0.21 %
CITY SERVICES COSTS		
Police	\$15,000	\$52,000
Fire	\$8,000	\$26,800
Parks	\$4,000	\$13,350
Libraries	\$2,250	\$7,350
Planning and General Government	\$5,250	\$17,500
Infrastructure Operations and Maintenance	\$3,200	\$10,700
Total City Costs	\$37,700	\$127,700
Total City Costs per unit	\$1,885	\$1,277
CITY SERVICES REVENUES		
Property Tax Revenue	\$21,000	\$52,500
Sales Tax Revenue	\$4,600	\$23,000
Utility Tax Revenue	\$2,000	\$11,200
Other Taxes and Revenues	\$4,100	\$21,000
Total City Revenues	\$31,700	\$107,700
Total City Revenues per unit	\$1,585	\$1,077
Net Difference	-\$6,000	-\$20,000
Net Difference per unit	-\$300	-\$200

Part II: Filling the Financial Gap

This section outlines what actions infill housing advocates can push their cities to take in order to pay for the infrastructure and public services that new residents of infill housing require. The strategies listed here generate additional revenue directly from the new development. These targeted revenue sources are the basic toolbox that each city has in order to fill the financial gap of infill housing. They fall into three basic categories:

Impact Fees are charged to a developer in exchange for approval of a development project. Fees can be levied with a simple majority approval of the city council, but they must meet more stringent legal requirements than other forms of targeted revenues. Parks or Traffic Mitigation Fees are examples of Developer Impact Fees.¹²

Special Assessment Districts are levied on both new and existing residents in an area to pay for specific improvements.

The revenues must be used to pay for a unique benefit to the affected property owners. They are established through a weighted simple majority vote of the affected property owners. Business Improvement Districts and Maintenance Assessment Districts are examples of this.¹³

Mello-Roos Districts require a two thirds majority vote to pass, but there is far more flexibility in how the revenue can be spent. Community Facilities Maintenance Districts are an example of this.¹⁴

The chart below summarizes some of the important differences between these three revenue sources.

Finally, *Value Capture from Upzoning* is an important concept when considering these three strategies for infill development. Although value capture is not a specific, revenue-generating strategy, it can provide a useful framework.

Table 2. Targeted Revenue Sources

	<i>Impact Fees</i>	<i>Special Assessments</i>	<i>Mello Roos Districts</i>
Who is charged	Developers applying for building permits	All property owners in the district	All property owners in the districts, except public buildings and other uses specifically exempted
How it is enacted	Simple majority of the city council, with findings	Simple majority of affected property owners, weighted by benefit accrued	Two-thirds majority of affected property owners/residents
Impacts on low-income communities	Potentially significant -- Only applies to new construction and affordable housing is usually (though not always) exempted. Can raise cost of all housing in a tight market.	Potentially significant -- No exemptions allowed, and voting system often disenfranchises low-income property owners	Varies -- Cities have significant flexibility in how tax is calculated, and who has to pay
What it can pay for	Most limited - the fee can only pay for additional infrastructure or services for new development. Must prove nexus and rough proportionality to service provided.	Can only pay for a “unique benefit” for affected properties. Best used to pay for additional services; can’t be bonded.	Most flexible – can pay for infrastructure and most services, and can be bonded.
What it’s good at paying for	New infrastructure that will obviously benefit the new development (ie. new roads, parks, sewers, etc.)	Small things that make a place special (ie. street festivals, special garbage cans or banners, special landscaping etc.)	Just about anything. Can be bonded for capital improvements, or used for services.
What it’s bad at paying for	Cannot be used to correct existing deficits. Also, while technically it can be used to fund services, it can be very hard to prove nexus and rough proportionality.	Cannot be used to replace any service already provided by the city. Cannot be bonded in order to pay for big infrastructure projects.	Cannot pay for transit service, unless the city is a charter city and chooses to write special formation papers.
Examples	Traffic Impact Fees, Parks Impact Fees	Business Improvement Districts	Community Facilities Maintenance Districts

Value Capture from Upzoning

What is value capture?

Cities and government agencies create value all the time: from a new public transit line to sewer upgrades to changes in the zoning code that increase the value of the land. All of these public sector actions make the properties around them more valuable, yet for the most part, the individual landowners get to keep all or most of that increased value in the form of higher profits when they eventually sell or develop their land. This unearned windfall may be great for land speculators, but ultimately it comes at the expense of taxpayers who paid for that public amenity in the first place.

Value capture is a broad term that covers any policy or agreement in which a government agency captures some of this unearned windfall in the private sector that arises from public sector activity. Value capture is based on the principle that the public should receive some of the economic benefits of its actions. Value capture is already widely used in California today. Tax increment financing, used by Redevelopment Agencies, uses anticipated increases in land value, and therefore in property tax revenues, to pay for new investments in infrastructure. California's 25 percent density bonus for developments that include affordable housing is another form of value capture; the city captures the economic value of increased density by requiring the developer to create additional affordable housing units.¹⁵

How can value capture help infill pay for itself?

Value capture can be a powerful tool to help cities recoup

the full cost of infill housing development. In order for it to work, it needs three things: (1) A government action that increases land value in a given area (such as new infrastructure investments or zoning changes); (2) A mechanism to capture that increased value (such as an agreement with the land owner, or a special tax, assessment, or fee); (3) A plan for how the money generated will be spent (such as to pay for the infrastructure investment, or to pay for other public amenities).

While value capture is frequently used when cities invest in new infrastructure, it is less widely used when cities create new land value through zoning changes. A 1-acre parcel zoned for 100 units is far more valuable than a parcel zoned for only 5 units. Yet when cities upzone an area, they rarely attempt to capture that increased value.

Today, this issue is more important than ever, as cities throughout California are increasing densities in their urban cores and around transit stations while at the same time running huge budget deficits. Cities can and have used a variety of mechanisms to capture some of the private windfall from these zoning changes to fund public amenities, including Developer Agreements, Density Bonuses, Developer Impact Fees, Special Assessments, Special Taxes, and Tax Increment Financing.

What are the equity impacts?

Value capture minimizes unearned windfalls to the private sector from public sector activities, and allows these windfalls to be used for public benefit. Of course, there is



San Francisco Eastern Neighborhoods.

Photo credit: J.G. in S.F.

Developer Impact Fees

no guarantee that the money generated through value capture will be used to further social equity goals. That is why advocates should ensure that there is a spending plan, and that social equity goals are articulated and incorporated into that plan from the beginning.

Case Study: San Francisco Impact Fee

In the mid-2000s, San Francisco initiated a Public Benefits Program for the Eastern Neighborhoods. As a part of the program, the city and community partners developed an Improvements Program that outlined community needs such as more parks, transit improvements, more library facilities, and more affordable housing. The city proposed establishing a Developer Impact Fee to cover some of the costs from the Improvements Program.

Significant changes in the zoning code were also being proposed as a part of this planning process. So, in order to establish the rates for the Impact Fee, the city conducted an analysis of the value created by the zoning changes for current landowners. They determined that, depending on the specific zoning change, the residual land values would increase anywhere from 8.5 percent to upwards of 20 percent on some parcels. The city established fees ranging from \$6 to \$16 per square foot based on the type of land use and number of additional stories allowed by the upzoning. Thus, as land became more valuable due to the city's upzoning, the city was able to capture some of that increased value and use it to pay for amenities outlined in the Improvements Program. According to city staff, the goal was to structure the impact fees to maximize what the city could exact while ensuring that the fees were reasonable enough that development would still move forward.¹⁶

The new plan and impact fees were adopted in early 2009. There have been no projects completed yet, and therefore no revenues generated. Under the approved fee structure, the city anticipates that nearly \$25 million in new revenues will be created in the next 5 years, which will cover 30 percent of the projected capital needs of the area.

Learn More:

Gihring, Thomas A. "The Value Capture Approach to Stimulating Transit-Oriented Development and Financing Transit Station Area Improvements." *Victoria Transit Policy Institute*. 2009.

San Francisco's Eastern Neighborhoods Public Benefits Program: <http://www.sf-planning.org/index.aspx?page=1673>

What are Developer Impact Fees?

Assembly Bill 1600 (Mitigation Fee Act, Government Code Section 66000 et. Seq.) allows cities to charge fees on new developments in order to cover the costs of infrastructure improvements and public services. Legislatively enacted fees can be approved by a simple majority of a city council, as long as the city provides sufficient findings that the fee bears a reasonable relationship to the community's needs in terms of the benefits provided and cost. In legal terms, this is known as *nexus* and *rough proportionality*. Cities can also levy ad hoc fees on individual developments, though such fees will be more heavily scrutinized by the courts. Fees can be levied on all types of developments, including housing, commercial, and office.

How can fees help infill pay for itself?

Many cities have historically adopted fees that simply averaged anticipated costs across all new housing developments at a fixed amount per unit. However, this does not take into account the impacts of density and distance to the city center on the cost of providing residential services. When fees are calculated more accurately, the city has more confidence that the costs of residential development will be covered by revenues from the development. Some cities, such as Lancaster, have corrected this oversight by calculating the exact cost of a development based on housing type, density, geographic location, and related factors.

Many for-profit infill developers can find these one-time, up-front fees difficult to finance. To respond to this concern, cities can set up payments to be pro rata as units actually become occupied, or go into a contract agreement with the developer to have the fees paid over time. For example, in 2009 the City of San Jose approved delaying final payment of parkland fees to five developments because of economic hardship due to the recession. Instead, the developers agreed to pay a monthly late fee and interest, and to pay the fee in full at a later date.

Effective January 1, 2011, cities can choose to exempt new development near public transit (ie. transit-oriented development) from paying traffic impact fees. Studies show that residents living near transit contribute less to traffic congestion than other residents; therefore, it makes sense that these residents should be exempted from a traffic impact fee.

What are the equity impacts?

Fees can have a range of impacts on local housing affordability, depending on market conditions and how the fees

are structured. In tight housing markets where residents lack housing options, the cost of the fee is often pushed on to the residents in the form of higher housing prices or higher rents. However, in more competitive markets, the cost of the fee is often absorbed by the land owner in the form of lower land value.¹⁷

Developments that have at least 50 percent affordable units can be exempted from fees, but that loss of revenue must be absorbed by the city and cannot be paid for by increasing the fee on other developments in the area. Because of this exemption, affordable housing developers often prefer impact fees compared to other policies to pay for new infrastructure and public services. Also, establishing impact fees to be based on square footage, and not as a simple per unit cost, can make the fee more equitable for lower-income families who often live in smaller homes.

Case Study: Lancaster Urban Structure Program

In the late 1980s, the City of Lancaster in southern California began to experience rapid residential growth. In 1992, the city created an Urban Structure Program to determine developer impact fees that would cover the infrastructure, facilities, and operations costs of new development.

Using sophisticated computer software, the city quantified what the projected 20 year shortfall for public services such as police and park maintenance would be, and added this shortfall to the impact fee. In addition, the city took into account the distance between the development and the service base station when calculating the cost of providing these services.

The city, developers, and residents realized two positive outcomes by calculating the fees this way. First, infill homes that were located near existing services were charged a lower fee that took into account the cost savings the city would realize from locational efficiencies. And second, according to city staff, the fees were effective at staving off most service cuts during the current recession.¹⁸ Thus, even as property tax revenues have fallen by more than 20 percent since the 2008-2009 fiscal year, the city has managed to prevent lay offs in the latest fiscal year.¹⁹ However, housing production, and therefore impact fee revenues, has dried up in the current economic recession, and the city has decided to discontinue the Urban Structure Program to focus instead on using zoning regulations to encourage infill development, rather than fee structures alone.

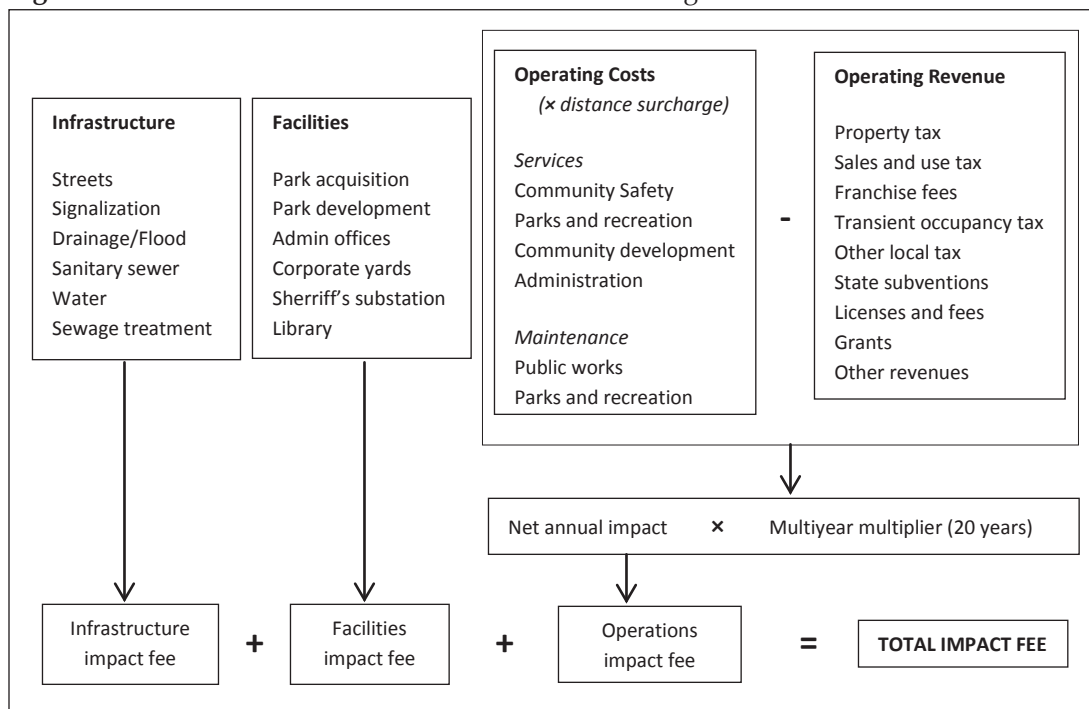
Learn More:

Peter N. Brown and Graham Lyons. "A Short Overview of Development Impact Fees." League of California Cities. 2003.

Gary G. Hill. "Paying for New Development: The Urban Structure Program of the City of Lancaster." *Government Finance Review*, Vol. 13:3. June 1997.

Arthur C. Nelson, et al. 2008. *A Guide to Impact Fees and Housing Affordability*. Island Press: Washington.

Figure 3. Fee Structure for Lancaster Urban Structure Program



Source: Adapted from Hill (1997)

Special Assessment Districts

What is a Special Assessment District?

Though often indistinguishable from traditional property taxes in how they are collected and paid, special assessment districts (SADs) are legally distinct from property tax, special taxes, and developer impact fees. In order to establish a SAD, it must be approved by a simple majority vote of the landowners within the district boundaries, weighted by the amount of benefit each landowner will receive from the district (and therefore how large of an assessment they will have to pay). SADs can be used to pay for operations and maintenance of public improvements, including landscaping, parks, street lighting, storm drains, streets, and similar such things, provided that the city can prove that the benefits are limited to the district boundaries and go beyond the basic services the city provides. There are over 20 statutes in the State Government and Streets and Highways Code that fall under the category of a Special Assessment District; the first one dates back to 1911.

How can Special Assessment Districts help infill pay for itself?

SADs cannot be bonded against, so they are not a good tool for financing major projects. However, they can still generate significant revenues for services and small projects such as street banners, landscaping, or pocket park maintenance. One of the most commonly used SADs in infill areas is a Business Improvement District (BID), in which businesses will pay a small assessment in order to improve neighborhood identity and attract more customers. Maintenance Assessment Districts (MADs) are similar and can apply to both residential and commercial areas.

Oftentimes, infill developers strive to carve out a unique and desirable community identity in the midst of the surrounding urban landscape. SADs generate new revenues to pay for the maintenance of special parks, landscaping, or bicycle and pedestrian facilities that help an infill neighborhood become more livable, safe, and attractive.

What are the equity impacts?

SADs came under much more stringent regulation after voters passed Proposition 218 in 1996. Prior to 1996, SADs could be established by a simple majority vote of the legislative body. Now, they must be approved by a simple majority vote of the landowners within the district boundaries, weighted by the amount of benefit each landowner will receive from the district. While some have suggested that this was a victory for democracy and resident control over taxation, others are critical that it is still not a truly

democratic procedure of “1 person, 1 vote.”²⁰ Large, usually richer, landowners cast a larger vote in establishing the SAD, and therefore in what it will fund, as well.

All properties that will receive a benefit from the SAD must be included in the district and must pay the assessment, including public properties and non-profits. While there is some flexibility in determining how to structure the assessment, it can only take into account various measures of the benefit accrued to the property, and not other considerations such as non-profit status or income level. So the burden of a SAD can fall particularly hard on older neighborhoods where homeowners may own their homes but have little cash on hand. Social justice advocates in some cities like San Diego, which has used MADs extensively, see these districts as a way to privatize city services.

Case Study: San Diego Maintenance Assessment Districts

In the 1980s, San Diego faced rapid population growth which, by the 1990s, led to a city-wide fiscal crisis.²¹ The city, unable to maintain the high level of city services that its residents desired, worked with developers and homeowners to establish Maintenance Assessment Districts throughout the city.

Today, the city has 56 MADs that, combined, raise over \$12 million annually in new revenues for services ranging from public events to increased security services to landscaping and parks maintenance. Roughly half of the MADs were formed by developers to ensure new developments would have a higher quality of service; the remaining were created through community outreach in existing neighborhoods in order to meet residents’ demands for increased services that the city could not afford, such as special landscaping. The below map shows the spread of where MADs were created throughout the city, with many of them established either where new development occurred on the urban fringe or in the central downtown area. The amount levied on each parcel is determined by parcel area, land use, number of dwelling units, parcel frontage, and building area. All but eight of the MADs are operated out of the Parks and Recreation department, and most have some form of community advisory board to establish priorities on budgets and spending.²²

The city continues to actively encourage new MADs to be formed. In 1998, the city passed a resolution in support of community efforts to establish MADs, and in 2004 it established a MAD formation fund to help communities with the initial start-up costs of creating a new district.

Mello Roos Community Facilities District

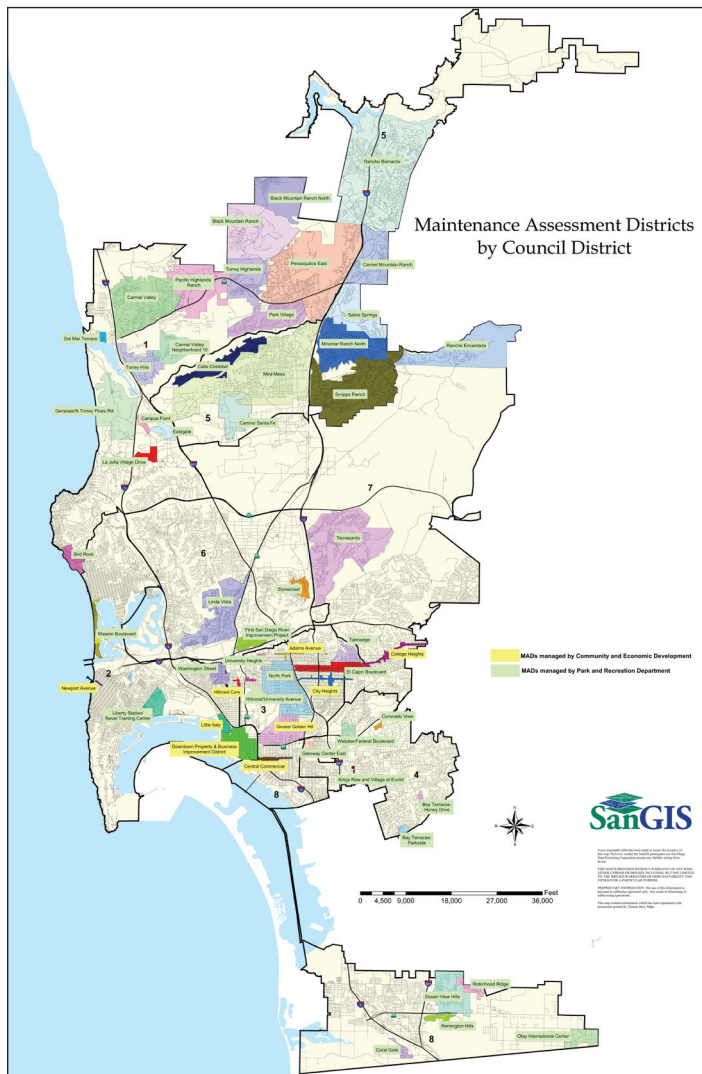
Learn More:

A Planner's Guide to Financing Public Improvements. 1997. Governor's Office of Planning and Research. <http://ceres.ca.gov/planning/financing/>

Kogan, Vladimir, and Mathew D. McCubbins. "The Problem with Being Special: Democratic Values and Special Assessments." *Public Works Management Policy*. 2009 14: 4

Erie, Steven, Vladimir Kogan, and Scott A. MacKenzie. 2011. *Paradise Plundered: Fiscal Crisis and Governance Failures in San Diego*. Stanford: Stanford University Press.

Figure 4: Maintenance Assessment Districts in San Diego



Source: City of San Diego

What is a Community Facilities District?

The Community Facilities District Act of 1982 (Government Code Section 53311 et. Seq.) allows jurisdictions to generate new revenues by levying a special annual tax on properties within an established district, known as a Community Facilities District (CFD) or a Mello Roos district after the authors of the legislation. Because it is a special tax, it requires a 2/3 majority vote by voters who reside within the district boundaries; unique to CFDs, a district can also be established by a 2/3 majority vote of the landowners if there are less than 12 residents in the district. The tax provides an important annual revenue source that cities can either bond against to finance up-front infrastructure improvements or use to pay for ongoing maintenance and services. CFDs can be used to fund police services, fire services, ambulance and paramedic services, parks maintenance and recreation programs, library services, and flood and storm protection services. CFDs cannot be used to fund transit service unless explicitly allowed in the CFD formation papers written by a charter city.²³

How can Community Facilities Districts help infill pay for itself?

CFDs have become popular over the years as a tool to finance infrastructure needs, particularly for new, greenfield development. Publicly-owned properties are exempted from it, as well as any other type of property explicitly stated in the formation papers. In general, developers prefer assessments like these that can be bonded against and paid back over time rather than one-time impact fees, which are much harder to finance.²⁴

Because of the onerous approval process to create CFDs in already populated areas, they are most oftentimes established in greenfield areas where there are very few residents and parcel sizes are large. Landowners will approve CFDs in order to pay for new roads and infrastructure in areas that lack these improvements. Large infill sites that do not currently have residents, such as underused parking lots or formerly industrial land, are also potentially viable places to establish a CFD.

What are the equity impacts?

Because it is an annual tax levied on property, CFDs usually pass on the costs of infrastructure and services to the homebuyer or renter. Historically, homebuyers didn't necessarily realize they were moving into a CFD until they got their first property tax bill and saw the extra charge. CFDs can cost a homeowner thousands of dollars a year, which can be a significant burden for struggling homeowners.

Today, there are full disclosure laws that require proper notification of CFD fees to homebuyers before purchase.

The amount for the special tax is determined using a special formula established by the city that takes into account land use, lot size, and square footage. Unlike impact fees, the revenues generated from CFDs don't have to meet the legal requirements of nexus and proportionality, which means that properties don't have to be assessed based on how much they cost the city. For example, larger units could be assessed at a much higher rate than smaller, more affordable units. In addition, cities do have the ability to exempt certain land uses or property types from paying the special tax. In theory, below-market rate housing units could be exempted from a CFD fee altogether.

Case Study: Contra Costa Centre Transit Village

The Contra Costa Centre Transit Village is a 125-acre area surrounding the Pleasant Hill BART station in Central Contra Costa County. Planning began in the early 1980s to convert the underutilized land into a walkable, liveable community. Nearly completed, the project today has over 2,700 homes, 2 million square feet of office space, and over 400 hotel rooms.

Contra Costa County created several CFDs to help finance

this project over the last 20 years. In 1991, the county established a district in order to help pay for a parking structure to serve the BART station and an upgrade for an offsite sanitary district facility. This first CFD was bonded for \$4.5 million. The county created a second, much smaller CFD in 1992 for \$125,000 that was designed to help some of the landowners in the area finance a new impact fee to pay for a child care facility on site. Finally, in 2008, they created a third CFD to fund ongoing maintenance of a bicycle/pedestrian bridge that connects two legs of a popular regional trail network over a wide and busy road.²⁵ All three of the district boundaries are small, encompassing only one to four property owners in the area. The bonds from the first two districts are expected to retire in 2018.

Learn More:

Daniel C. Bort. 2006. *An Introduction to California Mello-Roos Community Facilities Districts*. Orrick, Herrington & Sutcliffe LLP.

"Community Facilities Districts: Potential Use for Supporting Transit-Oriented Development." 2009. Prepared for North County Transit District of San Diego by KTU+A et. al.

Contra Costa Centre website: <http://centrepoinits.org>



New infill housing at the Contra Costa Centre Transit Village.

Photo credit: Uncredited

Part III: Case Study on San Jose

San Jose, California, is a city of nearly 1 million people at the southern end of the Bay Area. It is the third largest city in California, behind Los Angeles and San Diego, and the 10th largest in the country.

San Jose is in the midst of creating a new vision for its future. Under new state legislation, the Bay Area region must address ways to reduce greenhouse gas emissions through its transportation and housing planning processes. San Jose is moving forward with a new General Plan which seeks to meet this new environmental mandate through an urban villages vision of development that will reduce the amount residents will need to drive to get between home, work, school, and shopping. With an additional 500,000 people projected to live in San Jose by 2040, this is an ambitious plan to accommodate growth through targeted infill development.²⁶ The city is also in the process of creating a Station Area Plan for the 500 acres surrounding the Diridon transit station area. Diridon is a major regional transit hub near downtown that will include connections to local, regional, and state-wide mass transit by 2050.

However, these visions for a stronger, more sustainable future are under threat by today's economic conditions. San Jose today is slowly recovering from both the 2001 dot-com crash and the 2008 Great Recession. Unemployment in the city is over 10 percent, with the computer and technology industry taking a substantial hit. EBay, the third largest employer in San Jose, laid off 1,500 workers in 2008, 10 percent of its workforce. The city itself is also in the midst of a budget crisis. Home values in the area were hit hard in the recent recession, lowering property tax revenues significantly, and sales tax revenues have declined by 17 percent since 2008.²⁸ Meanwhile, costs for public services continue to rise.

San Jose's vision of a more sustainable future can be reached, but only with thoughtful consideration of how to ensure infill housing development is fiscally sustainable for the city. This case study will look at the current fiscal condition of the city, analyze how these costs and revenues play out with respect to infill housing development, and provide recommendations on how the city can make infill housing development pay its way.

History of Housing Development in San Jose

San Jose was established in 1777 as a Spanish colonial city. Through the 19th and first half of the 20th centuries, it grew to become an agricultural center for the country, producing nuts and fruit. Starting in the 1970s, the technology industry began to grow in the Santa Clara Valley and the lower Peninsula. As the largest city in the area, San Jose



Downtown San Jose.

Photo credit: City of San Jose

became the de facto capital of Silicon Valley. While the city population grew dramatically through the 1970s, 80s and 90s, most of the job growth happened in other nearby cities. San Jose developed a jobs/housing imbalance, with only 0.8 jobs for every worker who lived in the city.²⁸

Today, San Jose's population is incredibly diverse, with a high level of income and educational attainment. One third of the population is Hispanic, and nearly another third is Asian. Forty percent of all residents were born outside of the United States, and over half of the population speaks a language other than English at home. The median annual household income is roughly \$76,500, and over 80 percent of adults have a high school degree or higher level of educational attainment.²⁹

San Jose's History of Planned Growth

Starting in the 1970s, the city attempted to control its rapid growth through planning. Concerned with an explosion of growth that started in the 1950s, the city developed an urban development policy in 1970 that permitted urban development only within the Urban Service Area of the city. This policy is still in force today. San Jose adopted its first modern general plan in 1976, which included protection of hillsides and agricultural lands in some parts of the city and encouraged infill development.³⁰

Through the 1970s, most housing development occurred in the southern part of the city, while industrial and office uses were concentrated in the north. To try to correct this, the city began a concerted effort in the 1980s to revitalize the downtown and promote more jobs in the south and

downtown area. In 1987, the Santa Clara Valley Transportation Authority opened its first light rail line, connecting the southern residential areas to the downtown and employment centers in the north. Starting as early as the mid 1990s, the city began increasing densities along transit corridors in order to encourage multifamily infill development. Today, the system consists of over 40 miles of track and 62 stations. These light rail stations, in conjunction with major bus route lines, Amtrak, and Caltrain station, serve as the backbone of San Jose's urban villages vision.

Though only one third of San Jose's 300,000 homes today are multifamily, the city has pursued a policy of encouraging multifamily, infill housing development for over a decade. Nearly 80 percent of all new housing construction since 2000 has been multifamily, infill housing.

Fiscal Impact Studies of Housing Development

In the early 2000s, Silicon Valley was hit hard by an economic crash in the dot-com industry. Suddenly, the land that San Jose had slated for industrial and office use in the northern part of the city no longer had the same level of market demand. Developers were pressuring the city to convert the land to residential and build more housing. The city was concerned this land conversion might exacerbate the jobs/housing imbalance that already existed, and decided to study the issue further.

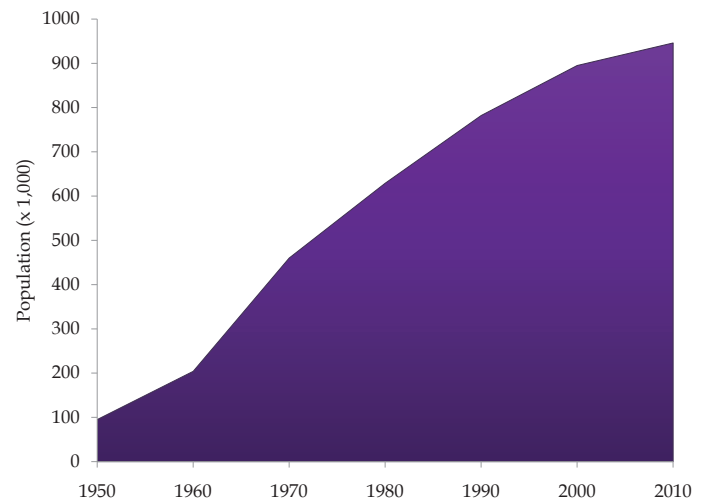
In 2004, the city commissioned Strategic Economics to do a fiscal impact analysis of residential, office, and commercial land uses in several sites throughout San Jose. While the report did ultimately find that the city could accommodate a significant amount of infill multifamily housing development in several areas, it noted that the financial burden of providing services for these new homes – particularly police, fire, parks, and libraries – made housing a potential net financial loss for the city without office or commercial development to support it.

The analysis here takes the Strategic Economic report as a starting point, updates the numbers to reflect current economic conditions, and analyzes the costs and revenues from both single family and multi-family housing.

Current Fiscal Conditions

Today, in 2011, the economy is in a major recession. San Jose has reduced both its budget and staffing considerably as revenues continue to fall. San Jose's budget is nearly \$3 billion total, though the 2011-12 budget would decrease it to \$2.5 billion. Roughly 30 percent of revenues are from the general fund. Another 35 percent are capital improvements (mostly bonds and fees), 20 percent are from special revenues (such as the low income housing fund and waste management), and 15 percent are from enterprises (primarily the airport and sewage management). For the last several years, the city has been balancing its budget by drawing down its reserves. In 2007-2008, reserves were 24

Figure 5: San Jose Population Growth, 1950 - 2010



Source: City of San Jose, 2011

percent of the budget; in 2011-12, they make up barely 10 percent. The city employed 5,840 FTEs (full-time equivalents) last year, and is proposing reducing this number to 5,200 for the 2011-2012 fiscal year.

In order to build a model of fiscally sustainable development, it is important to understand the city's current fiscal conditions. Below is an overview of both the costs and revenues associated with residential development.

Public Services Costs

Public Safety The city has about 1,620 police officers and 770 fire fighters. Combined, police and fire make up about 40 percent of the city's operating staff and over 50 percent of general fund uses. Police cost the city roughly \$300 million annually, while fire costs an additional \$150 annually. Performance objectives for both police and fire are based on response time to emergency situations. Budget cuts, population growth, county land annexation and infill development have all negatively impacted emergency response times, according to departmental information.³¹ There are 33 fire stations throughout the city, but the proposed budget plans to have temporary, rolling closures of two stations each day to reduce operating expenses.

Parks and Recreation The city of San Jose has nearly 200 trails, regional parks, and neighborhood parks. Park maintenance and operations, as well as recreation and community services, totaled \$55 million in 2009-2010. The city has proposed reducing it to \$45 million for the upcoming fiscal year. Under the Capital Improvement Program, there are sufficient funds to build several new parks; however, the city lacks enough revenues to operate and maintain the parks, and has therefore halted some of the planned park construction until more funding is available.³³

Libraries The city currently has 19 libraries, with four more planned (though construction has been indefinitely de-

ferred). Libraries employed 300 FTEs last year; this year they are proposing reducing FTEs to 230, with partial closure of some libraries. Operations and maintenance was \$30 million for 2009-2010.

Public Works Public works includes facilities maintenance, fleet and equipment services, and infrastructure planning and building. The budget for these services has declined from \$60 million to a proposal of \$50 million for 2011-2012.

Planning and Community Development There are roughly 210 FTEs in the planning, building, and code enforcement, down from a high of nearly 370 in 2008. The cost was roughly \$25 million for 2009-2010.

General Government General government includes the City Manager's office, City Council, City Attorney, human resources, information technology services, and more. There were nearly 600 FTEs in 2010-2011; the proposed budget would reduce that to just over 500 FTE. The budget was \$76 million in 2009-2010, with a proposed reduction to \$69 million in the upcoming fiscal year.

Waste management, sewage, and water are managed via fee for service and so are not included in the analysis here.

General Revenues

Property Tax Property taxes have declined by five percent from a high of over \$200 million in 2008. Because this analysis is city-wide, it does not take into consideration the impact of geographically-specific programs, like Redevel-

opment Areas, on city property taxes.

Sales Tax The sales tax rate in Santa Clara County is 9.25 percent. San Jose sales tax revenues are strong overall, compared regionally. Sales tax data from 2008 shows that San Jose has a net positive sales tax flow, meaning the city is attracting consumers from other jurisdictions.³³ However, the economic recession has decreased sales tax revenues for the city by 17 percent.

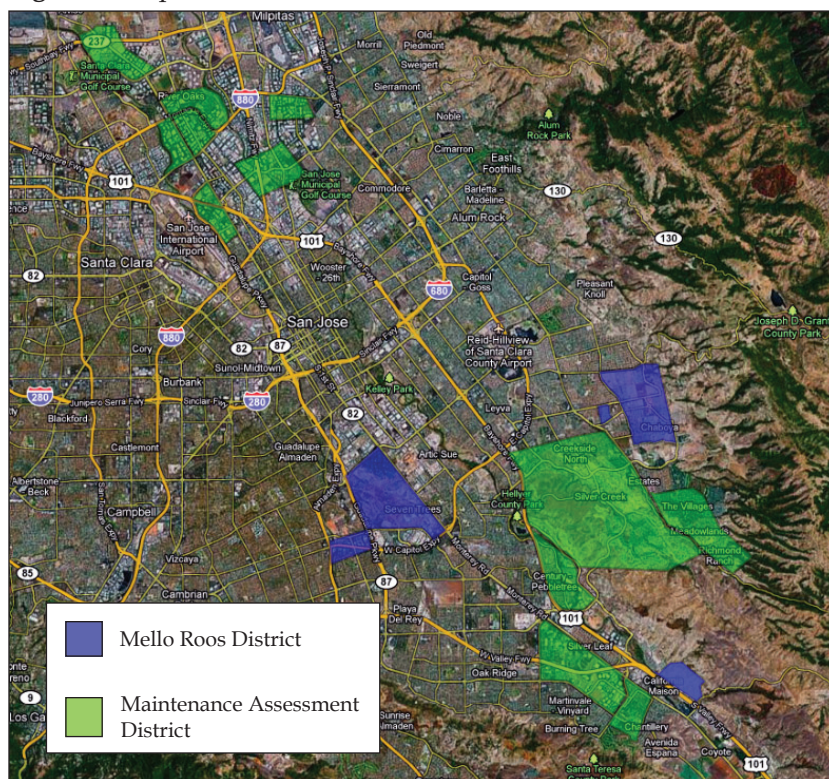
Franchise Fees, Licenses and Permits, and Fines These revenue sources come from both residential and non-residential land uses. Combined, they add up to \$85 million a year in revenues. Franchise Fees are charged to third-party companies such as PG&E for the use of public right-of-ways (primarily streets) to provide their services. Licenses and permits include building permits, business licenses, and more. Fines include traffic violations, judge sentences, and other such fines.

Utilities User Tax The city charges a five percent general tax on all utility bills, including gas, water, electricity, and telephone.

Revenue from Local Agencies The city receives reimbursement from other agencies for providing services to residents who live in Special Districts, such as the Central Fire District.

Telephone Tax The telephone tax was voter-approved in 2009, and is generating \$20 million per year of new general revenues.

Figure 6. Map of Mello Roos and Maintenance Assessment Districts



Source: Based on data from City of San Jose, 2011

Special revenues

In addition to the general revenue sources listed above, the city also has several other special revenues to help pay for housing development. These are divided up into revenue sources for operations and maintenance, and revenue sources for capital improvements.

Revenue Sources for Operations and Maintenance

Library Parcel Tax This parcel tax provides funding for development, operations, and maintenance for specific services within the city from development. The tax ranges from \$25 per unit for single family to under \$10 per unit for large multi-family projects, with Consumer Price Index-based increases annually.

Maintenance Assessment Districts There are 13 Maintenance Districts throughout the city, which provide roughly \$11 million a year for maintenance of street islands, street frontages, and other, mostly landscaping-related, elements.

Mello Roos Districts San Jose has 6 Maintenance districts, and 4 bonded districts. Together, bonds are for \$42 million, primarily for street construction and maintenance. Revenue from non-bonded districts is roughly \$7.5 million annually and is primarily for maintenance of roads, waterways, and landscaping in the district.

Revenue Sources for Capital Improvements

Park Impact Fee The city's Park Dedication Ordinance and Park Impact Ordinance (PDO-PIO) were passed in 1988 and 1992, respectively, to ensure new development maintains a ratio of 3 acres of parkland for every 1,000 residents. Fees range from \$10,000 to \$34,000 per unit, depending on the city zone, project density, and estimated number of residents per unit. Under this formula, higher density projects pay roughly 1/3 less in fees per unit because the city assumes they have fewer residents per unit. These fees can only be used for the development or renovation of parks.

Traffic Impact Fee In 2005, San Jose established a Traffic Impact fee for North San Jose in order to pay for the major traffic improvements necessitated by the newly adopted North San Jose Area Development Policy, which includes up to 32,000 new housing units, as well as significant office and commercial development. The fee is \$6,994 for single family units, and \$5,596 for multi-family units. It can only be used for capital expenditures.

Residential Construction-related Tax, and Other Special Taxes Four separate taxes related to residential construction add up to 4.5 percent of the total project costs for new development. These taxes are established flat rate for all development; however, in 2000 the city approved a policy that exempts multifamily residential development in the downtown area from all of these taxes.

Infill Housing Costs and Revenues Analysis

Below is a table showing the analysis of how the costs and revenues for city services add up for both single family and multi-family homes in San Jose. Infrastructure costs and revenues (such as impact fees) are not included in this analysis, neither are place-specific costs and revenues (such as the Maintenance Assessment Districts). Costs are calculated on a per capita basis, based on the city's average residents per unit. Revenues are calculated on a per unit basis or according to pre-established city formulas where they exist. The numbers are mostly provided by actuals from the 2009-2010 fiscal year. For a full discussion of the numbers and calculations, see Appendix A.

This analysis is static, which means it is meant to give a "snapshot" of the fiscal impact of housing development on the city under current conditions. It does not attempt to project how the costs and revenues might change over time.

While the specific dollar amounts presented here may vary depending on neighborhood-specific conditions, this analysis reveals three important things overall:

1. Multi-family housing development generally costs the city less than single family on a per unit basis;
2. Both single family and multi-family housing development generally come at a net fiscal loss for the city of thousands of dollars annually; and
3. Multi-family housing development has a lower net fiscal loss per unit than single family development.

This analysis provides some support to the city's efforts to redirect housing development towards lower-cost infill housing with the urban villages vision. It also points to the need for the city to implement additional revenue generating strategies with new housing development. Below are three recommendations for ways the city can raise more revenues from new housing development.

Recommendations

1. Value capture from upzoning

San Jose is adopting a new vision for growth centered around urban villages. Not only will these urban villages create more transportation and lifestyle options for San Jose residents, but they could also dramatically increase land values in these areas due to new infrastructure investments and zoning changes that allow for denser, higher value development. According to a 2009 study by Shishir Mathur and Christopher E. Ferrell, home values increase by 1.5 percent for every 1000 feet closer a home is to a transit station in the San Jose area.³⁴ As the city moves forward in planning out each new urban village, it has a unique opportunity to capture some of this newly created value and use it to cover the costs of new, infill homes.

Table 3: San Jose Infill Housing Costs and Revenues Analysis

	Single Family	Multi Family
ASSUMPTIONS		
Density (Gross)	4	20
Acres	5	5
Total Residential Units	20	100
Avg. Person per Household	3.5	2.3
Median Cost per Unit	\$480,000	\$245,000
Property Value	\$9,600,000	\$24,500,000
Avg. Property Tax Revenue to City	0.21%	0.21%
CITY SERVICES ANNUAL COSTS		
Police	\$15,586	\$51,210
Fire	\$8,208	\$26,970
Parks & Community Service	\$4,060	\$13,340
Library	\$2,240	\$7,360
Public Works	\$3,270	\$10,743
Planning & Community Development	\$1,268	\$4,167
General Government	\$5,670	\$18,630
Total City Services Annual Costs	\$40,302	\$132,421
Total City Services Annual Costs per unit	\$2,015	\$1,342
CITY SERVICES ANNUAL REVENUES		
Property Tax	\$20,160	\$51,450
Sales Tax	\$4,560	\$22,800
Utility Tax	\$2,240	\$11,200
Franchise Fees	\$2,066	\$6,789
Fines, etc.	\$861	\$2,828
Licenses and Permits	\$1,497	\$7,486
Revenue from Local Agencies	\$2,319	\$11,595
Telephone Tax	\$989	\$4,945
Library Parcel Tax	\$500	\$920
Total Annual Revenues	\$35,192	\$120,014
Total Annual Revenues per unit	\$1,760	\$1,200
Annual Net Difference	-\$5,110	-\$12,407
Annual Net Difference per unit	-\$255	-\$124

There are several mechanisms a city can use to capture this value increase. First, the city could create a new Developer Impact Fee, like San Francisco did in the Eastern Neighborhoods area. The fee rate could be set in direct proportion to the amount of additional value the parcel would accrue through the upzoning process.

Another approach could be to create new Mello Roos Maintenance Districts. Mello Roos can be an incredibly flexible revenue-generating tool for cities; its primary constraint is the high voter approval needed in order to establish a district. A district is easiest to establish in areas that do not have a large number of residents already living there, and where there are few land owners. Several of San Jose's urban villages, such as the Diridon Station Area, have these characteristics and would be well positioned to succeed in establishing a Mello Roos district. The Contra Costa Centre is a successful example of how Mello Roos was used on an infill project near transit to raise revenues for both capital

costs and ongoing maintenance expenditures.

Wherever the city is planning to upzone to higher densities of infill housing development, the city should conduct an economic impact analysis to determine how much additional value is being created for landowners from the upzoning, and which strategy would be most appropriate to capture part of that windfall value.

Finally, and most importantly, a spending plan must be in place so that all stakeholders have a shared understanding of how the new revenue will be spent. The spending plan gives residents and infill housing advocates an important space to voice concerns and priorities.

2. Raise specific revenues for specific shortfalls

As was noted in the Strategic Economic report, San Jose has a specific funding shortfall for city parks maintenance

that can be corrected by modifying the park impact fee. The city has addressed this cost to some degree in its draft General Plan by allowing and encouraging the use of Joint Use Agreements with schools. Joint Use Agreements make school recreational facilities available to residents and thus create new neighborhood park spaces. However, the city still lacks adequate funding to pay for ongoing park maintenance.

One potential solution to this particular problem would be to include ongoing maintenance costs in the park impact fee. The City of Lancaster developed a Developer Impact Fee structure that calculated the anticipated costs for 20 years of maintenance and operations (see Part II of this report for more information on this case study). San Jose could adopt a similar fee structure for calculating the park impact fee.

One important caveat to note is that impact fees cannot be used to make up pre-existing deficits. So while this new impact fee would ensure that there will be sufficient funding for operations and maintenance of parks near new development in the future, it could not be used to resolve the current funding gap for existing park maintenance needs.

3. Enable Special Assessment Districts

As San Jose's continuing budget crisis forces more cuts and declining levels of service, the city could explore making it easier for neighborhoods to create Special Assessment Districts (SADs). SADs can be used to provide additional services by charging a small annual fee to property owners in the area, based on the amount of benefit the owner

receives from the district. The city can facilitate community processes to create SADs by providing seed funding for educational materials or running the voting process to establish a SAD.

SADs should never be used to backfill services the city ought to be providing, such as basic parks maintenance or street repair. However, as the city's budget continues to tighten, residents will find it much more difficult to get the city to pay for small improvements that make neighborhoods unique and interesting, such as special street lighting, banners, or garbage receptacles. This is particularly true for the new urban villages the city envisions. Thus, SADs are one strategy the city could use to pay for these types of special improvements.

Finally, with every discussion of strategies to raise more money for city governments, there must be an honest consideration of who will ultimately pay for it. San Jose has a tight housing market, and any new costs the city imposes on development will likely be passed on to the new residents themselves. For infill housing advocates concerned about making new housing affordable to residents at a range of incomes, this fact is particularly troubling. There are no perfect strategies here, though there are some potentially promising ones. When determining which strategy to pursue, it's important to have an honest discussion with all stakeholders about the strengths and constraints for each one. However, through an open and transparent decision-making process, San Jose can create a model for new infill homes that are both environmentally and fiscally sustainable.



Infill homes in San Jose.

Photo credit: Greenbelt Alliance

Appendix A: Methodology for San Jose Analysis

For this fiscal analysis, I relied on two sources in particular: the 2011-12 San Jose draft budget for data on actual costs and revenues from 2009-2010; and Strategic Economics' fiscal impact analysis from 2005. The former was used primarily for the raw data for the calculations, while the latter was used to develop the methodology used here. I also referred to calculations by Michael Coleman of costs and revenues of single family versus multi-family development.

A few things to note: I chose to calculate the city costs on a per capita basis, and then multiplied it out based on the Average Persons per Household used by the city. This is because most level of service standards the city has for services, such as parks, is calculated on a per capita basis. City Revenues, on the other hand, are calculated on a per unit basis because most revenues (property tax, utility user tax, etc.) are collected on a per unit basis.

Calculations of city costs can be done either by looking at the increment of cost by new housing, or by averaging costs across all residents. Incremental cost factors in excess capacities in existing facilities, while simply averaging costs does not. Since this analysis is meant to generically apply across the entire city, it was not feasible to calculate excess capacity of place-based facilities such as police stations, fire stations, parks, and libraries. Instead, I used average costs across all city services.

Assumptions:

The data sources for the assumptions are as follows:

1. Density – Given.
2. Acres – Given.
3. Total Residential Units – Given.
4. Average Persons per Household – City of San Jose's PPH used in calculating Parks Impact Fees. Last updated 2009.
5. Median Cost per Unit – Santa Clara County Association of Realtors, March 2011.
6. Property Value – Calculated.
7. Property Tax Rate – Michael Coleman. A Primer on California Finance. League of California Cities. 2005.

Ongoing City Costs:

The costs include police, fire, parks, libraries, public works, planning & community development, and general

government. The first four of these costs are considered standard resident services, and San Jose provides all of them to its residents as a full service city. These costs mainly cover operations and maintenance, and do not include any capital investments that would be necessary as the population grows. Public works includes operations and maintenance of public works facilities. Planning & community development include all planning services, including long range planning. General government covers the costs of basic government administration. These last three costs are considered "fixed" when looking at the incremental cost of individual housing developments; they are included in this analysis because it is assumed that they will need to grow to keep pace with population growth, which is projected to increase by 50 percent by 2040.

The calculation of costs assumes that both workers and residents benefit from police, fire, public works, and planning & community development, while only residents benefit from parks, libraries, and general government. Thus, for the first category, the cost is spread out over both residents and workers.

For example, costs for police are calculated as:

Cost of police per dwelling unit = (2009-2010 Police Actuals / (2010 population + 2009 jobs)) * Average Persons per Household

These numbers are explained as follows:

1. 2009-2010 Police Actuals is the total cost of providing police services during the 2009-2010 fiscal year, according to City of San Jose budget data.
2. 2010 population is the total population based on the 2010 US Census (total pop: 945,942).
3. 2009 jobs is the total number of jobs in San Jose. It is based on 2009 numbers from the US Census' Longitudinal Employer-Household Dynamics, the most recent year that city-level data is available (total jobs: 355,234).

This analysis is repeated for fire, public works, and planning & community development.

For parks, libraries, and general government the cost per dwelling unit was calculated as follows:

Cost of parks per dwelling unit = (2009-2010 Parks Actuals / 2010 population) * Average Persons per Household

In this case, because these services are used almost exclusively by residents, their entire cost is charged to the residents.

Ongoing City Revenues:

City revenues included in this analysis are: Property tax, sales tax, utility tax, franchise fees, fines, licenses and permits, revenue from local agencies, telephone tax, and library parcel tax. Each of these will be explained in more depth below. General revenues that were not included in this analysis are: transient occupancy tax, business taxes, transfers and reimbursements from non-local agencies, and other revenues. These were excluded because they are generally not generated from residential uses.

In addition, there are four construction taxes imposed by the city that were not included in these calculations: Construction and Conveyance Tax; Construction Excise Tax (also called the Commercial-Residential-Mobile Home Park Building Tax); Building and Structure Construction Tax; and Residential Construction Tax. These taxes are used overwhelmingly to pay for capital improvements on streets or parks, and so are not included in this analysis of revenue sources for ongoing services. Likewise, the Parks Impact Ordinance and the Traffic Impact Fee are not included in this analysis for the same reason. Special Assessment Districts and Mello Roos districts are also not included in these calculations because they are geographically constrained revenue sources.

Property tax, sales tax, utility users tax, and library parcel tax are calculated using their own formulas, as described below. All other revenues are calculated based on contributes from both households and employers. Because employer size (and therefore contribution) varies dramatically, I developed a proxy by converting the number of jobs in the city into households based on the city-wide average number of residents per household, which was 3.14 in 2010. Thus, I assume that every 3.14 employees in San Jose contribute roughly as much revenue as one household for these particular revenue sources.

All revenue data is calculated using 2009-2010 budget actuals from the 2011-2012 Draft Budget, except where noted otherwise. Explanation of individual revenues:

1. Property tax – Calculated as 0.21 percent of property value. See Assumptions calculations, above, for more information.
2. Sales tax – Data is taken from an analysis of household sales tax revenues by CBRE Consulting, Inc. conducted in December 2008. The number was reduced by 17 percent to account for decline

in sales tax revenue from 2008 to 2010, as reported in the 5-year Comparison of General Fund Sources provided by the city.

3. Utility users tax – Amount is calculated based on pay rate scale and average utility usage for single family and multi-family homes in San Jose. The calculated rate for single family homes is \$120/yr. the rate for multi-family homes is \$86/yr. Data is from City of San Jose and PG&E. The utility users tax rate is 5 percent.
4. Franchise fees –These are calculated on a per capita basis as a proxy for amount of service consumed per household. Revenues are adjusted to account for both households and businesses.
5. Fines –These are calculated on a per capita basis because they are collected per capita. Revenues are adjusted to account for both households and businesses.
6. Licenses and permits –Revenues are adjusted to account for both households and businesses.
7. Revenue from local agencies – These revenues are primarily transfers for city services provided to residents in special districts. For example, the city receives payments from the Central Fire District for services provided by the San Jose Fire Department. Because businesses may also reside in special districts, revenues are adjusted to account for both households and businesses.
8. Telephone tax – This telephone tax was voter approved in 2008 (Measure J). Without more specific information about trunk lines in specific developments, I used city averages adjusted for both households and businesses.
9. Library parcel tax – Data is based on rates for single family and multi-family homes, as outlined in City of San Jose Municipal Code 4.79. This parcel tax was voter approved in 2004 (Measure S).

Finally, it's important to note that both revenues and costs have fluctuated dramatically in the last several years. The numbers used in this analysis should be used for illustrative purposes only, and do not necessarily reflect the actual costs and revenues of housing development in the city.

Notes

1. See Michael Coleman. *A Primer on California City Finance*. League of California Cities, 2005.
2. See Sarah Lynn Cunningham. "Do You Want Utilities With That? Avoiding the Unintended Economic Consequences of Poorly Planned Growth on the Provision of Water and Sewer Service." Practice Guide #14; and Cameron Speir and Kurt Stephenson. "Does Sprawl Cost Us All? Isolating the Effects of Housing Patterns on Public Water and Sewer Costs." *Journal of the American Planning Association*, 68: 1, 2002.
3. Cunningham (undated).
4. John I. Carruthers and Gudmunder F. Ulfarsson. "Urban Sprawl and the Cost of Public Services." *Environment and Planning B: Planning and Design*. Vol. 30, 2003.
5. See John I. Carruthers and Gudmunder F. Ulfarsson. "Does 'Smart Growth' Matter to Public Financing?" *Urban Studies*. 2008.
6. Coleman 2005.
7. Ibid.
8. Lenny Goldberg and David Kersten. "System Failure: California's Loophole-Ridden Commercial Property Tax." California Tax Reform Association. May 2010.
9. Though commercial land uses are the location where sales happen, it's important to recognize that residential land uses are necessary in order to have people that shop at these stores. For more on the fiscalization of land use, see John V. Thomas. "Dividing Lines and Bottom Lines: The Forces Shaping Local Development Patterns." *Journal of Planning Education and Research* 25: 275-293.
10. See Coleman 2005.
11. Ibid.
12. William W. Abbott, Peter M. Detwiler, M. Thomas Jacobson, Margaret Sohagi, and Harriet A. Steiner. 2001. *Exactions and Impact Fees in California: A Comprehensive Guide to Policy, Practice, and the Law*. California: Solano Press Books.
13. Ibid. Also see Vladimir Kogen, and Mathew D. McCubbins. "The Problem with Being Special: Democratic Values and Special Assessments." *Public Works Management Policy*, 2009 14: 4.
14. D.C. Bort. 2006. *An Introduction to California Mello-Roos Community Facilities Districts*. San Francisco: Orrick, Herrington & Sutcliffe LLP.
15. See Nico Calavita and Alan Mallach. 2010. *Inclusionary Housing in International Perspective: Affordable Housing, Social Inclusion, and Land Value Recapture*. Cambridge, Mass.: Lincoln Institute of Land Policy.
16. Author email correspondence with Sarah Dennis Phillips, Senior Planner with the City of San Francisco, July 2011.
17. See Jennifer S. Evans-Cowley and Larry L. Lawhon. "The Effects of Impact Fees on the Price of Housing and Land: a Literature Review." *Journal of Planning Literature*. 2003.
18. Author interview, Chuen Ng, City of Lancaster Associate Planner, June 14 2011.
19. City of Lancaster Program and Fiscal Plan 2010-2011 and 2011-2012.
20. Kogan and McCubbins 2009.
21. Steven Erie, Vladimir Kogan, and Scott A. MacKenzie. 2011. *Paradise Plundered: Fiscal Crisis and Governance Failures in San Diego*. Stanford: Stanford University Press.
22. Author interview, Andrew Field, Assistant Deputy Director, Park and Recreation Department, City of San Diego, August 30, 2011.
23. *Community Facilities Districts: Potential Use for Supporting Transit-Oriented Development*. 2009. See Sacramento for an example of a CFD that allows funding for transit services and bike and pedestrian facilities.
24. Author interview, Kate White, Urban Land Institute San Francisco Executive Director, April 7 2011.
25. Author interview, Jim Kennedy, Contra Costa County, July 21, 2011.
26. Draft of *Envision San Jose 2040 General Plan*. Projections are from ABAG.
27. City of San Jose 2011-12 Proposed Operating Budget.

28. Draft of *Envision San Jose 2040 General Plan*.
29. US Census, 2010.
30. Draft of *Envision San Jose 2040 General Plan*.
31. City of San Jose 2011-12 Proposed Operating Budget.
32. Author interview, Kristen Clements, Director of Policy, San Jose Housing Department, July 12, 2011.
33. CBRE Consulting Inc. Memo entitled: "Mountain View Retail Leakage Study." Dated December 12, 2008.
34. Shishir Mathur and Christopher E. Ferrell. "Effect of Suburban transit Oriented Developments on Residential Propoerty Values," *Mineta Transportation Institute*. 2009.

