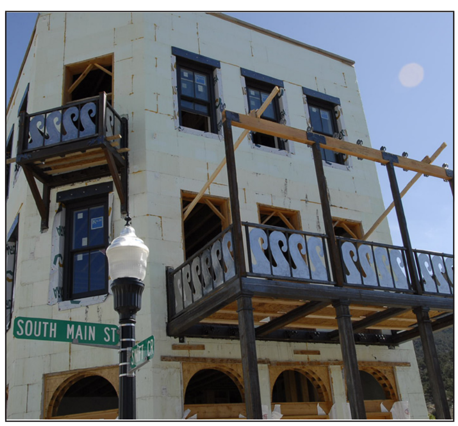
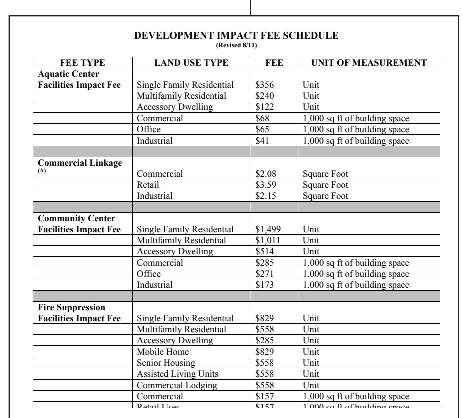
CITY OF PETALUMA, CA

Petaluma SMART Rail Station Areas: TOD Master Plan





DEVELOPMENT IMPACT FEE SCHEDULE
(Revised 8/11)

FEE TYPE	LAND USE TYPE	FEE	UNIT OF MEASUREMENT
Aquatic Center Facilities Impact Fee	Single Family Residential	$356	Unit
	Multifamily Residential	$240	Unit
	Accessory Dwelling	$122	Unit
	Commercial	$68	1,000 sq ft of building space
	Office	$65	1,000 sq ft of building space
	Industrial	$41	1,000 sq ft of building space
Commercial Linkage (A)	Commercial	$2.08	Square Foot
	Retail	$3.59	Square Foot
	Industrial	$2.15	Square Foot
Community Center Facilities Impact Fee	Single Family Residential	$1,499	Unit
	Multifamily Residential	$1,011	Unit
	Accessory Dwelling	$514	Unit
	Commercial	$285	1,000 sq ft of building space
	Office	$271	1,000 sq ft of building space
	Industrial	$173	1,000 sq ft of building space
Fire Suppression Facilities Impact Fee	Single Family Residential	$829	Unit
	Multifamily Residential	$558	Unit
	Accessory Dwelling	$285	Unit
	Mobile Home	$829	Unit
	Senior Housing	$558	Unit
	Assisted Living Units	$558	Unit
	Commercial Lodging	$558	Unit
	Commercial	$157	1,000 sq ft of building space

Prepared By:

Deliverable 9.a

Development Incentives Memo

January 2012

urban advisors ltd

Development Incentives Memo

City of Petaluma, CA

Petaluma SMART Rail Station Areas: TOD Master Plan

Deliverable 9.a
January 2012

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Petaluma SMART Rail Station Areas: TOD Master Plan
Deliverable 9.a: Development Incentives Memo
Prepared for the City of Petaluma, California

Development Incentives and Funding Resources

Over the last fifty years a variety of mechanisms have been formulated to assist in meeting the challenges of development in blighted areas or in areas where demand was not assured or funding was insufficient. We are now in an economic climate where these incentive programs are becoming less effective for a City like Petaluma because the challenges are not the direct result of weak market demand—in fact the market demand for multifamily has rarely been stronger. The current challenges for Petaluma are based upon the problems of a national economy that has suffered economic shocks from financial markets and a housing bubble. Currently, financing is available for low risk transactions such as sales of existing multifamily units and new suburban apartment types, and for loans to proven development entities that have deep pockets in cash and equity to guarantee the loan. Financing is also going to investors purchasing existing single tenant, credit tenant retail properties. Construction financing for new mixed use is seen, in most geographic markets, as too risky with too low a return. Mortgage requirements for individuals have become more stringent with higher down payment requirements. High unemployment has lowered the numbers of households which qualify for financing. There is an overhang of foreclosed units statewide, and a crash of housing values locally that together make the pre-sales and financing of new ownership units more difficult than in the past.

Because of the current difficult climate for financing for construction and for mortgages, alternative solutions may be necessary to spur development in the short term. The design team has worked through alternatives with financial analysis and believes that what is being proposed is feasible. At this time, market feasibility based on lease rates and sale prices does present some difficulty but the lack of financing availability because of the recent downturn may be a greater obstacle. Perhaps most important at this time are measures that increase project net income and therefore project value. This lowers the perceived risk and enhances the potential for the projects to receive financing. The following pages outline a number of means for enhancing the bottom line for the proposed projects and increasing the probability of financing

Measures to Increase Project Profitability and Probability of Financing

Change Impact Fee Formula for Multifamily TOD

One of the stumbling blocks to meeting market conditions is the per-unit impact fee structure for multifamily. The fees remain the same no matter what the unit size, and this adds a burden to the provision of smaller units for one and two person households and for the creation of affordable units. The current fee structure is a very great disincentive to the proposed transit-oriented development and, at the same time, a positive incentive to build the largest units possible. At an average unit size of 1,000 square feet, the cost per square foot for the impact fee is approximately $41. For a 500 square foot unit the cost per square foot of the fees doubles to $82, but the leasable space is halved, lowering project feasibility. If the formula for the fees were based upon square feet of use, the developer would have the flexibility to respond to market conditions and affordability without rising project costs. The justification for such a change is in the fact that this is transit-oriented development and, as recognized in California law, should have lower traffic impacts than residential development in areas where the use of a car is an absolute necessity. Changing the impact fee formula would increase the feasibility of proposed development by increasing the certainty of developer flexibility to meet markets and by increasing profitability if a mix and range of units is contemplated.

Public Agencies Act as "Master Developer"

Where parcels are publicly owned, the responsible agencies can provide a development program and structure through development agreements to enable small projects that combine to make the whole, and couple this flexibility with terms that increase the probability of funding. Parcels owned by SMART can offer the incentive of deferred payment or participation agreements to offset upfront and carrying costs resulting from land purchase. This is completely justifiable as long as the ultimate purpose is to recoup the public cost while providing social benefit. It is suggested that land owned by the public be offered with pricing and terms that vary according to the social utility of the project proposed. In a typical development, parks and open space, public access, and income range addressed are all usually limited. The plan proposes public amenities such as parks and plazas available to all of the public and a unit mix wide enough to create opportunities for a range of household incomes. While we have suggested funding sources to aid in development of a complete community, varied pricing and individual parcel development is an avenue of assistance to help the City and SMART meet social goals that might otherwise prove difficult to attain.

Differential Temporary Tax Assessment for Satisfaction of City Goals

If Tax Increment Financing is unavailable, an option for the City might be a lowered property tax assessment of City property taxes for the first five to ten years of the project. The difference that this would make is in project valuation by financing agencies. If a project has a City tax bill based on the City rate (not including county or state) of $1 million and it is lowered to $500,000, the increase in project value would be in the range of $7.1 million. Thus, reducing the tax burden temporarily can substantially increase the viability of the project for gaining financing. This is being carried out by the City of Portsmouth, Virginia for areas where financing has been difficult.

Direct Means of Financing

One of the ways the City can respond to the problems presented by the current institutional intransigency of traditional lending sources is to create their own funding entities and enjoining lenders to participate in pools that limit their risk, sidestep their loan committees and satisfy Community Reinvestment Act requirements.

Community Development Financial Institution (CDFI)

Community Development Financial Institutions (CDFI's) often used for for affordable housing can be used for any community purpose, and have a variety of formats from a quasi-public entity to a private consortium. CDFI's are created to use funding from public and private sources to enable development that otherwise might not be financed. They work with Community Development Entities (the actual developers) to fund and build projects for the community good. All of the development proposed for this area is eligible to be funded by a CDFI.

CDFI's can also be organized as consortia of traditional funding sources. Creating a local consortium to fund development in this area may enable financing. The most difficult constraint to development cited by developers was the current difficulty to achieve financing for any project no matter how feasible. A consortium helps with this problem by requiring only small investment by any one lender, investor or financial institution. As such, it also operates outside of the typical loan committees at banks who are bound by legal rules regarding fiscal prudence and therefore unlikely to undertake the funding of an entire project in the current economy. A consortium for Petaluma could also be a CDFI and make use of tax credits and other financial vehicles.

A quasi-public CDFI can be organized by the City and can include banks and other investors in a consortium to fund financing for projects such as the TOD development at station areas. This directly addresses the problem of standard financing and may be one of the few ways to accelerate project timing in the present national financial circumstances.

Community Development Entities (CDE) Associated with CDFI's

Any development entity can become certified as a CDE and is then eligible to collaborate with a CDFI on a development project. The advantage is access to alternative funding sources that can include public, private and even charity funding. It is suggested that a pro-active approach be undertaken, inviting developers to become CDE's along with a program for forming a CDFI for central City development. The City would then be able to recruit development entities that share their goals. The combination of a CDFI and a CDE program could be quite powerful.

Down-payment Assistance for Residential Units

Down payment assistance can be used to help qualified renters become property owners. The use of this assistance in the study area could increase the potential demand for units here by adding to the number of people able to gain funding for unit ownership. Increasing the number of guaranteed sales increases the feasibility of gaining construction financing. Guaranteed sales are a guaranteed means of gaining financing.

Employment Space Construction Funding

Employment space can be funded through CDBG funding using HUD Section 108 funding. In Portland Oregon, for instance, an employment retention program allows funding to employers for construction of $50,000 per employee and has no payments for the first five years. At the end of five years, if the business leaves its premises, the loan must be paid, otherwise if continued occupation is guaranteed the loan is forgiven. This is a powerful incentive that relies upon partnership between the City and employers.

Small Business Investment Company

Small Business Investment Companies (SBIC's) are business development venture funds for business creation and development that are regulated by the Small Business Administration. The federal government will match local funding at a two to one ratio. What this means is that if local investors, banks and others form a SBIC with $5 million in start-up funding (the minimum investment), the Small Business Administration matches this on a two-to-one basis, forming a total fund of $15 million for the purpose of funding new business. SBIC's are allowed to use funds for investment in small business and to act as an advisory resource. This means that the SBIC employees could fund and advise businesses on issues such as effective use of information technology, effective retailing practices, financial management, employee management, efficient use of resources, etc. The City and the Chamber of Commerce could institute a committee to research the feasibility of setting up an SBIC and work with local investors and local and state financial institutions to fund it initially.

Indirect Incentives

Add the Station Area infrastructure to the Capital Improvement Program

Building infrastructure and public amenities are important components of development. Developers and financing entities have a greater perception of certainty and City commitment when the City actually builds the infrastructure and amenities necessary for a project prior to commitments on the private side.

In the project scenarios that were preferred, the developers are expected to cover between approximately 45 and 65 percent of infrastructure and amenity cost, and under that assumption, development is feasible. According to estimates by Carlile Macy, total infrastructure and open space costs for the project alternatives is over $17 million. In evaluating these costs, approximately $7 to $8 million are onsite costs paid for by development (to be conservative the costs attributed to site infrastructure and open space in the pro formas is approximately $11 million).

Estimated impact fees for the more feasible alternatives are shown in the table below. To use the impact fees from this project, the improvements shown in the plans need to be added to the City Capital Improvement Program and given a priority for timing of expenditure. That said, the alternatives produce traffic impact and park and park development fees sufficient to pay for the improvements necessary. While not all of the impact fees are for site infrastructure, the fees that would apply amount to approximately $18.8 million as shown in the following table.

Impact Fees for Preferred Alternatives

Fee Type	Multifamily	Commercial	Totals
Aquatic Center	94,903	13,419	108,322
Commercial Linkage	NA	775	775
Community Center	400,383	56,321	456,704
Fire	221,168	31,108	252,276
Law Enforcement	333,992	46,764	380,756
Library	170,662	23,992	194,654
Open Space	1,554,692	218,369	1,773,061
Park Land	843,533	117,724	961,257
Park Development	2,191,720	207,186	2,398,907
Public Facilities	380,425	53,474	433,899
Traffic	4,958,151	3,782,221	8,740,372
Wastewater	2,271,145	101,662	2,372,807
Water Meter	979,900	489,155	1,469,055
In Lieu Housing	1,986,030	NA	1,986,030
Storm	91,644	91,496	183,140
Art	NA	304,985	304,985
Specific Plan	86,553	21,603	108,156
Total	**16,564,900**	**5,560,255**	**22,125,155**

While provision of infrastructure is a very useful incentive, to allay the risk aversion of lenders in the current climate it may be useful to investigate alternative formats for financing such as participation in a low-risk consortium like a CDFI.

Redevelopment Area Tax Increment Financing (TIF)

One of the methods for financing the public parts of new projects is the use of tax increment financing. Despite the fact that the status of redevelopment and the use of TIF are currently undergoing scrutiny in court and at the state level, it is useful to enumerate the potential for funding provided in the project scenarios.

Since development is subject to the uncertainty of markets, it is difficult to say how fast the project area will develop, and that affects how much bonding can be undertaken. If the entire project area is built out, an estimate of value created less current assessed values is in the range of $214 to $258 million. Market values in Petaluma are approximately 1.02 times higher than assessments resulting in a taxable value change of between $210 and $253 million. At a debt service ratio of 75 percent of total new taxes, this results in debt service of between $1.7 and $2.1 million available to pay bond debt. For a 4.5%, 20-year bond, this allows a bond value of between $22.6 and $27.3 million. If the City chooses to bond only on the basis of City tax revenue, leaving school and other funding and the county portion of tax revenue out of the TIF, the value of bonds would range between $10.2 and $12.3 million. Since the project will not be built at one time, these estimates will necessarily be reduced. It is possible to issue bonds for separate phases as development commences to deal with this uncertainty.

TIF has statutory requirement for 20% of the revenue to be used for affordable housing. If this is considered as 20% of the value bonded, depending on the portion of the taxes devoted to TIF, this amount could vary between $2 million (City portion only) and approximately $5 million (all tax revenue).

Other Sources for Infrastructure and Public Facilities Funding

There are numerous other sources for infrastructure and public facilities funding outlined in the memo for this project “Potential Infrastructure Needs Analysis and Financing Strategy Memo,” by Carlile-Macy and the October 6 memo from Lisa Wise Consulting on infrastructure financing. Many are problematic as they add a burden of debt to the City or the project developers. The difficulty is that the economy has lowered revenues from property and sales taxes and lessened the public appetite for assuming debt. At the same time, adding more taxes or fees (as is done with business improvement districts or Mello Roos Community Facility Districts) to the development lowers project feasibility and acts as a disincentive to financing. Of the programs listed in the memos, the following are loan programs that would add debt either to the developers project or to the city: the California Infrastructure And Economic Development Revolving Fund Program; Community Loan Funds using federal resources, Downtown Petaluma Business Improvement District; General Obligation Bonds; Infrastructure Financing Districts; and Mello-Roos Community Facility Districts.

Among the programs that offer funding for infrastructure and are not disincentives to development are: the use of the collected impact fees used for the project by inclusion of improvements in the CIP; EDA grants; Sonoma County Measure M Fund; Propositions 1B and

42 funding for transit, congestion reduction, transportation and storm drainage; tax increment financing (discussed above); and the MTC Transportation for Livable Communities Program.

EDA grants are funds provided from the economic development administration of the US Department of Commerce. These grants have been used in California for 22 funded projects in the 2009 2010 fiscal year as noted in the memo by Lisa Wise consulting. Station area projects may be eligible for these grants under the part of the program that funds public works and economic development programs.

Sonoma County Measure M created a fund based upon a quarter cent sales tax for transportation improvements. When passed, part of the funds raised was expected to be spent upon station site development.

Proposition 1B is a local partnership program passed in 2006 allocating $20 billion in State of California general obligation bonds to fund transportation projects. The city of Petaluma has used these funds for recent projects.

Proposition 42 allocates California gas tax funds for congestion relief and transportation improvements that aid in the relief of congestion and also allows reconstruction and storm drainage repair on existing rights-of-way.

Project Incentives and Affordable Housing Incentives

Funding for affordable housing has been addressed in the October 6 memorandum from Lisa Wise Consulting, "Petaluma Smart Rail Station Areas: TOD Master Plan Affordable and Workforce Housing." Among the incentives listed in the memo are: the Bay Area Transit Oriented Affordable Housing Fund; Petaluma Commercial Linkage Fees; Petaluma In-Lieu Housing Fund; Petaluma Community Development Commission Low Income Housing Fund; Home Investment Partnership Act; Community Development Block Grants; And Low Income Housing Tax Credits (LIHTC). All of these programs should be investigated for their use in funding the affordable housing component within the proposed project areas. By themselves, funding incentives for affordable housing can help feasibility where affordability is desired, but are not sufficient to incentivize the entire project. To achieve project financing with affordability a mix of policy changes and other financing means is likely to be necessary.

An example is the Low Income Housing Tax Credit program. While LIHTC is a program that can help to build affordable units in the study areas, it is of insufficient significance to overcome the barriers to financing presented by the current economic situation and City permit cost barriers. The maximum credit is approximately eight percent on eligible cost. For Phase 1 of Blocks 1 and 2, for instance, rental residential costs are slightly over $15 million. At 15 percent affordable units, the credit would be ± $181,000, an amount too small to change feasibility for a total project cost in the range of $42 million.

Incentives that provide grants and below market rate financing may be especially useful. Two of them are listed below

Home Investment Partnerships Program (HOME)

HOME offers grants and loans to create affordable housing. These grants are often used in combination with LIHTC credits and standard financing to enable affordability. Grants are made on a project basis and given directly to the developing entity.

California Multifamily Housing Program (MHP)

The Multifamily Housing Program is to fund the new construction, rehabilitation and preservation of permanent and transitional rental housing for lower income households using deferred payment loans with terms up to 55 years at 3% interest. According to the State of California the following activities and development entities are eligible:

> New construction, rehabilitation, or acquisition and rehabilitation of permanent or transitional rental housing, and the conversion of nonresidential structures to rental housing. Projects are not eligible if construction has commenced as of the application date, or if they are receiving 9% federal low income housing tax credits.
>
> MHP funds will be provided for post-construction permanent financing only. Eligible costs include the cost of child care, after-school care and social service facilities integrally linked to the assisted housing units; real property acquisition; refinancing to retain affordable rents; necessary onsite and offsite improvements; reasonable fees and consulting costs; and capitalized reserves.
>
> Local public entities, for-profit and nonprofit corporations, limited equity housing cooperatives, individuals, Indian reservations and rancherias, and limited partnerships in which an eligible applicant or an affiliate of an applicant is a general partner. Applicants or their principals must have successfully developed at least one affordable housing project.

The below market interest rates and long term financing make this an attractive incentive for affordable housing.

Predevelopment Loan Program

Up to $100,000 in funding at below market interest rates for predevelopment activities associated with provision of affordable housing, available only to agencies or non-profit public benefit corporations.

Other Project Funding

HUD Economic Development Loans (Section 108 Funding)

Section 108 is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 provides communities with a source of financing for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. This makes it one of the most potent and important public investment tools that HUD offers to local governments. It allows them to transform a small portion of their CDBG funds into federally guaranteed loans large enough to pursue physical and economic revitalization projects that can renew entire neighborhoods.

Use / Guidelines: Activities eligible for Section 108 financing include:

- economic development activities eligible under CDBG;
- acquisition of real property;
- rehabilitation of publicly owned real property;
- housing rehabilitation eligible under CDBG;
- construction, reconstruction, or installation of public facilities (including street, sidewalk, and other site improvements);
- related relocation, clearance, and site improvements;
- payment of interest on the guaranteed loan and issuance costs of public offerings;
- debt service reserves

Since the programs for site development include many of the activities listed as eligible, Section 108 funding merits a closer look by the City.

Transit Oriented Development (TOD) Housing Program

State of California funding, both loans and grants, for gap financing for rentals in TOD that include affordable units and mortgage financing assistance for home-ownership units in TOD. Also eligible is funding for infrastructure improvements necessary to create connections to transit stations. Projects must be within a quarter mile of the transit station. Applicants include cities and counties, transit agencies, developers, and redevelopment agencies. Terms, from the State of California website are as follows:

> Maximum Program loan or grant, or combination of the two, for a single Housing Development or for a single housing developer applicant, including any affiliates of such applicant, shall be limited to $17 million per funding round. The total maximum amount of Program assistance for applications based on a single Qualifying Transit Station and all awards of Program funds over the life of the Program shall be $50 million.

Recommendations for Project Implementation

Effective incentives for development will require a mix of both policy and funding initiatives, and a timeline to prioritize the first phases of new development in the station areas. Based upon feasibility studies, the order of development is likely to be Blocks 5 and 6, then the Haystack site (Blocks 3 and 4), and finally the Golden eagle properties (Blocks 1 and 2).

Developing Blocks 5 and 6 (the SMART Sites)

In applying scarce city resources, a logical starting place would be the blocks owned by SMART. Because these blocks at the station are under public ownership, the obstacle of land acquisition that exists for the Golden Eagle and Haystack sites is not present. As such these blocks are a unique opportunity and can act as catalyst sites to help create a new urban center to support downtown, demonstrate public commitment and illustrate project feasibility to future financing entities. Working together, the City and SMART can act as master developers to allow incremental project development that could greatly aid in obtaining financing by enabling smaller projects.

To implement projects on the opportunity sites on Blocks 5 and 6, it is recommended that the City work with SMART to create acquisition and development agreements that will help to enable financing and lower initial project cost. Among these are: deferred payment with a reappraisal at a pre-determined time; ground leasing at below market rates for a defined period with a buyout after project stabilization; simple time payments with a balloon payment after a reasonable period of years; and/or site subdivision into small units to enable smaller scale parcel-by-parcel development.

For the short term, the City could build the infrastructure and amenities shown on Blocks 5 and 6 to create the urban framework necessary for the development. Among the ways to do this are:

- Inclusion of the public amenities and improvements shown on blocks 5 and 6 in the city capital improvement plan to allow funding via the assessed impact fees.
- Investigate the use of Proposition 1B and Sonoma County Measure M funds for infrastructure on or adjoining the site.

Public ownership and the urban infrastructure created by the public would allow the sites can be sold as small development projects instead of requiring a single very large project with one deep-pocketed developer. Small projects lower risk and increase the viability of financing. To do this would require either SMART or the City to act as a de facto master land developer, subdividing sites as necessary to achieve projects that can be built in the current market.

Successful development at Blocks 5 and 6 may carry the City through the current economic downturn into a time of more robust pricing ands leasing rates when development envisioned in the plan for the other sites will be more easily financed and will not require incentives other than the profits offered by the market.

Policy and Funding Measures

Create a new mixed-use multifamily residential impact fee structure for transit-oriented development that assesses fees based not upon unit count but upon building square footage. The importance of removing the current disincentive to a mix and range of unit prices and sizes cannot be over-emphasized.

The city of Petaluma should consider creating a package of funding sources to guarantee the financing of the affordable residential component of this project. Since most of these sources cannot be accessed prior to at least some project design, the city should partner with the developers chosen development entities to gain funding approvals from administering agencies such as the Bay Area Transit Oriented Development Affordable Housing Fund, the California HOME Investment Partnership Program, Low Income Housing Tax Credits administered through the State of California, and the California Multifamily Housing Program.

The city of Petaluma should consider partnering with private sector investors and lenders to create a CDFI consortium fund for station area development. Because of its quasi-public nature, a CDFI is able to use funds from a variety of sources, can help banks achieve their community reinvestment act responsibilities, lowers individual investor's risk, and can thus guarantee funding to satisfy city goals.