

# Affordable Housing Finance Analysis

Technical Report

*August 10, 2023*

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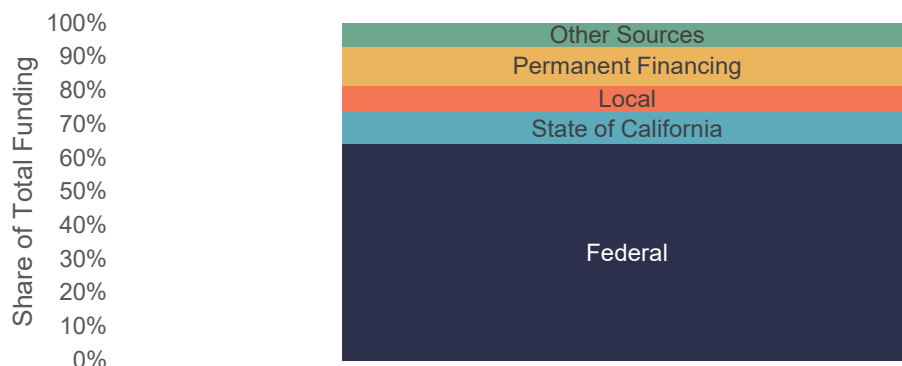
# Executive Summary

Strategic Economics identified barriers and opportunities for development of new affordable housing in Petaluma based on analysis of affordable housing pro forma financial statements, developer interviews, and concurrent housing studies in Petaluma. This analysis considered housing production trends, financial opportunities and barriers for affordable housing projects, and the ways in which Petaluma's regulatory, permitting, and approval processes impact new housing production. The City of Petaluma commissioned this study as part of its General Plan update process to inform City staff and decision makers' considerations of policies impacting affordable housing production.

**Petaluma, like many other California cities, has significant affordable housing needs and must increase production of new affordable housing units to meet State Regional Housing Needs Allocation (RHNA) mandates.** Petaluma's housing needs are most significant for low, very low, and extremely low-income populations. Over the past eight years, Petaluma has been relatively successful in producing new housing units for moderate and above moderate-income households but has trailed in producing units for households with low or very low-incomes. During this time, affordable housing developers have also faced numerous external challenges for completing their projects, such as COVID-related supply chain issues, rising construction costs, and delays securing utility hookups.

**Deed-restricted affordable housing projects in Petaluma are not receiving as much funding support from local sources as projects elsewhere in the Bay Area—making it more difficult to compete for state funding and other sources to cover the funding gap for these projects.** These projects rely on public subsidy from multiple sources to fill the gap between total development costs and the total revenue generated by affordable housing units. As shown in Figure 1, the majority of this public funding typically comes from state or federal sources, but local funding plays a critical role in closing funding gaps and making projects more attractive for competitive state and federal funding sources. Prior to the City's recent passage of fee waivers for affordable housing, recent affordable projects in Petaluma received just eight percent of their total funding from local sources. This was far less than the 30 to 40 percent received from local sources for projects in Santa Clara County and San Francisco. Though these jurisdictions are much larger in population and have access to greater resources, they still compete with Petaluma for affordable housing developer interest and outside funding.

**Figure 1: Typical Funding Sources for Affordable Projects in Petaluma, 2020-2021**



Source: California Tax Credit Allocation Committee, 2020-2021; Strategic Economics, 2023.

**Local regulatory, permitting, and approval processes are also making it more challenging for new housing projects to be successful in producing affordable housing units.** Existing policies and regulations are limiting developers' flexibility to pursue new affordable housing projects. Local affordable housing developers expressed that the City's parking requirements and expectations for ground-floor retail limit their flexibility to produce viable projects by requiring costly additions that may not be needed on their particular site. Similarly, there are opportunities to increase the flexibility of the City's inclusionary housing policy so that it can be leveraged to produce a larger number of affordable units via land dedications and partnerships with affordable housing developers. Affordable housing developers can also experience significant challenges navigating Petaluma's processing and approvals process. Examples of these challenges included interdepartmental communication, unclear design expectations, and a lack of staff resources to process applications quickly. Each of these challenges can add significant time and additional costs to new affordable housing developments, making it less likely that they succeed.

**Recent changes by the City of Petaluma are already starting to alleviate some of these issues.** For example, the Petaluma City Council passed a resolution in November of 2022 to exempt deed-restricted affordable housing projects from the City's facilities, parkland, traffic, and open space impact fees. In addition, the City recently combined Housing and Planning activities into a joint Community Development Department—a step that should help remedy some of the challenges of interdepartmental communication. As part of ongoing departmental changes, the City is also hiring additional planning staff, including an additional affordable housing coordinator and a homeless services coordinator in 2023. The new Community Development Department completed a Strategic Plan in 2023—a document that seeks to address many of the challenges and goals identified in this report.

**Petaluma can further increase opportunities for affordable housing production by adopting new funding measures, reducing costs for new developments, and increasing certainty for developers.** The City can also support naturally-occurring affordable housing through accessory dwelling units (ADUs) by supporting homeowners who are interested in new construction of these units. Strategic Economics recommends the following policy considerations:

- **Adjust local funding and financing strategies to grow the pool of funding for 100 percent deed-restricted affordable housing projects and to better leverage external resources.**
  - Support expanded approaches to increase City funding contributions, such as reallocation of General Fund expenditures, pursuit of voter approval for new tax measures dedicated to affordable housing, more flexibility for developers to provide in-lieu fees, and the creation of a City-owned land bank.
  - Support county or regionwide approaches to increase outside funding that can be allocated to affordable housing development, such as county-level affordable housing bond measures or support for the Bay Area Housing Finance Authority (BAHFA).
  - Clarify expectations regarding the circumstances under which alternative mitigations to inclusionary housing requirements are allowed, with particular emphasis on allowing 100 percent affordable housing project development via land dedication and other contributions.
  - Target and support affordable housing development opportunities in areas that are more competitive for state funding, such as High Resource areas and places in close proximity to assets like libraries, parks, and the existing and proposed SMART stations.

- **Reduce cost barriers for affordable housing unit production by modifying impact fee requirements for market-rate projects and adjusting ground floor retail requirements for affordable projects.**
  - Through the General Plan process, revisit and modify the locations in which ground floor retail is required as part of affordable, inclusionary and market-rate housing development projects.
    - Alternatively, consider providing blanket waivers of this requirement for 100 percent affordable projects.
  - Study potential unintended impacts of the current impact fee structure for market rate units, and whether it could incentivize smaller, more naturally-affordable units if it was based on the square footage of developments instead of the total number of housing units for multifamily development projects and ADUs.
  - Consider impact fee reductions or waivers in exchange for greater affordable housing production in market rate housing development projects.
- **Provide greater certainty and timeliness for new housing approvals to accelerate production of affordable housing units by reducing risks and costs for housing development projects.**
  - In line with the upcoming Corona Road SMART Station PDA Specific Plan effort, consider creation of additional area plans to provide clarity and to reduce the extent of environmental review required for individual development projects.
  - Complete and implement the City's current efforts to create more objective standards for design review and development approvals.
  - Implement internal process improvements to provide greater efficiency and transparency for development applicants—as identified in the Community Development Department Strategic Plan.
  - In addition to the two staff positions being added by the Housing Department in 2023, continue analyzing potential opportunities to increase City staffing resources.
- **Increase guidance and financial support for development of new Accessory Dwelling Units (ADUs).**
  - Continue increasing financing and education opportunities for homeowners who are interested in constructing ADUs, such as the City's partnership with the Napa Sonoma ADU Center as of January 1, 2023.
  - Continue efforts to simplify and clarify the process for developing ADUs.

# Introduction

This report identifies barriers and opportunities for development of new affordable housing in Petaluma. Strategic Economics conducted this analysis as part of Petaluma's General Plan update process, in conjunction with recent updates to the City's Housing Element. The intent of this work was to inform City staff and decision makers' considerations of policies that impact and enhance affordable housing production.

While other analyses for the Housing Element focused on identifying Petaluma's housing needs, constraints, and recommendations for delivering additional housing, the findings described in this report focus specifically on the impact of funding, market and financial conditions, and regulations on the ability of developers to produce affordable housing.

Strategic Economics compiled findings from previous housing studies, developer pro forma financial statements, and interviews with local developers of affordable and market rate housing to provide this overview of affordable housing feasibility factors in Petaluma. This report also incorporates findings of the City's recently adopted Housing Element, which was partly informed by the same developer interviews conducted for this report.

This report incorporates consideration of the ways that market-rate housing production can be used to support affordable housing. One area of overlap is inclusionary housing, in which market rate housing developers are required to either integrate affordable housing units into their projects or to provide other forms of assistance (such as land donation or an in-lieu fee) to aid affordable housing development. Inclusionary policies can be an effective means of producing more affordable housing, but also result in additional constraints on the production of market rate housing. As such, there is a complex relationship between inclusionary policies and their overall impacts on housing production. This report explores that relationship as well as general local conditions for producing affordable housing.

The report is organized into six primary sections:

- **Introduction:** The remainder of this section provides definitions for key concepts and terms used throughout this report.
- **Housing Production and Housing Needs:** Provides an overview of Petaluma's recent housing production trends and housing needs.
- **Financial Opportunities and Barriers for Affordable Housing Projects:** Describes how affordable housing projects are funded and identifies the local funding gap for affordable housing construction in Petaluma.
- **Regulatory and Policy Environment:** Reviews the state, federal, and local policy context for producing affordable housing in Petaluma.
- **Processing and Approvals:** Examines the impacts of development project processing and approvals on affordable housing production.
- **Strategy Recommendations:** Summarizes policy recommendations for increasing affordable housing production in Petaluma.



# Affordable Housing Key Concepts and Terms

**Housing prices are considered affordable if a household pays less than 30 percent of its monthly income on housing costs.** Households whose housing-related expenses exceed 30 percent of their income are referred to as housing “cost burdened.” Deed-restricted affordable housing units help to reduce cost burdens for households within specific income categories. Deed-restricted housing units target households within select income categories, which are based on the region or county’s median household income. Rents and sales prices are set at below market-rate (BMR) levels so that households pay no more than 30 percent of the targeted income level for their income category.<sup>1</sup>

**The California Department of Housing and Community Development (HCD) publishes income limits for extremely low, very low, low, and moderate-income household categories.** These categories are used to determine eligibility for many state and local programs, and to project household growth by income category for the purposes of Regional Housing Needs Allocation (RHNA). Income limits are set by county, with thresholds for each income level based on the county’s area median income (AMI). In Petaluma, the Sonoma County income limits apply. Based on HCD’s 2023 income limits, Sonoma County’s household income levels correspond to the following:

- **Very Low Income:** Households earning 50 percent or less of Sonoma County AMI. A family of four earning \$62,900 or less in 2023 would be categorized as very low income.
- **Low Income:** Households earning 51 to 80 percent of Sonoma County AMI. For a family of four, this amounts to an annual income of \$62,901 - \$100,650 in 2023.
- **Moderate Income:** Households earning 81 to 120 percent of Sonoma County AMI. For a family of four, this amounts to an annual income of \$100,651 - \$153,700 in 2023.
- **Above Moderate Income:** Households earning 121 percent or more of Sonoma County AMI. For a family of four, this amounts to an annual income of greater than \$153,700 in 2023.

In addition to these affordable housing definitions, a variety of agencies and key terms will be referenced frequently throughout this report. The definitions below introduce agencies, terms, and their acronyms.

- **Accessory Dwelling Unit (ADU):** The California Department of Housing and Community Development defines accessory dwelling units as being “accessory to a primary residence” with “complete independent living facilities for one or more persons.”<sup>2</sup> An ADU can be attached to the primary structure, or detached (separate) from that structure. ADUs can be created through the conversion of an existing bedroom, garage, or storage area. In cases where the converted unit is contained entirely within the primary single-family residence, the unit is referred to as a **Junior Accessory Dwelling Unit (JADU)**.
- **California Debt Limit Allocation Committee (CDLAC):** The California Debt Limit Allocation Committee administers the State’s tax-exempt bond program. Its programs include first-time home buyer services as well as the bond program for California’s residential rental project tax credits.
- **California Department of Housing and Community Development (HCD):** The California Department of Housing and Community Development, or HCD, is a State agency focused on increasing the supply of safe

<sup>1</sup> This practice does not entirely eliminate housing cost burden for low-income households. Because maximum costs are based on a target income level for each group of households, housing cost burden can still occur in cases where the household’s income is below the target income level for their category. However, the BMR restrictions reduce the households’ housing cost burdens below the levels of market rate rents.

<sup>2</sup> California Department of Housing and Community Development, “Accessory Dwelling Unit Handbook,” Update July 2022, p 3.

and affordable housing through providing funding opportunities, crafting regulations, and assisting with policy and planning.

- **California Housing Finance Agency (CalHFA):** The California Housing Finance Agency is the State's affordable housing lender. It provides financing and programs targeted to homebuyers, lenders, and renters to ensure that more housing is accessible to low- and moderate-income Californians.
- **California Tax Credit Allocation Committee (TCAC):** The California Tax Credit Allocation Committee is the State's agency to administer Low Income Housing Tax Credit programs, as described below.
- **Low Income Housing Tax Credit (LIHTC):** The LIHTC program is a Federal and State tax subsidy that gives investors a roughly dollar-for-dollar credit on their tax liability in exchange for equity contributions to subsidize affordable housing development projects. LIHTC equity is often the largest source of subsidy for affordable housing production and may also be used for affordable housing preservation. There are two major types of tax credits: 9% credits, which are highly competitive, and 4% credits that are paired with tax-exempt bonds.
- **Naturally Occurring Affordable Housing (NOAH):** NOAH is defined as older, privately owned, unsubsidized rental housing that offers lower rents in comparison to newer units. These units are not deed-restricted, and but may be affordable to lower-income households.
- **Regional Housing Needs Allocation (RHNA):** The Regional Housing Needs Allocation (RHNA) is the process used by the State of California to allocate the state's housing needs across all local jurisdictions. The State requires regional councils of governments throughout California to develop methodologies for distributing housing needs within their regions. For Petaluma, this process is carried out by the Association of Bay Area Governments (ABAG).

# Housing Production and Housing Needs

Strategic Economics reviewed Petaluma's recent affordable housing production trends to establish the performance of the city in producing housing under existing market and regulatory conditions. The following findings explore Petaluma's recent performance in producing housing. This progress was compared to the housing need targets of the RHNA planning period that commenced January 31, 2015 and ran through January 31, 2023. The findings provide an overview of housing production, identify how Petaluma fared in comparison to peer communities within Sonoma County, and conclude with discussion of changes in RHNA targets for the current cycle running from 2023 through 2031.

## Housing Production Trends

**Petaluma grew its housing stock significantly in the early 2000s, but did not maintain this growth through the decade starting in 2010.** As shown in Figure 2, Petaluma's count of housing units grew by 12 percent from 2000 to 2010, but only two percent from 2010 to 2019. In part, this slowdown reflects a nationwide lull in the housing market following the Great Recession. However, Petaluma's housing stock grew by just two percent between 2010 and 2019, a rate that matched the county overall but was slower than housing growth in peer communities of Rohnert Park, Santa Rosa, and Sonoma.

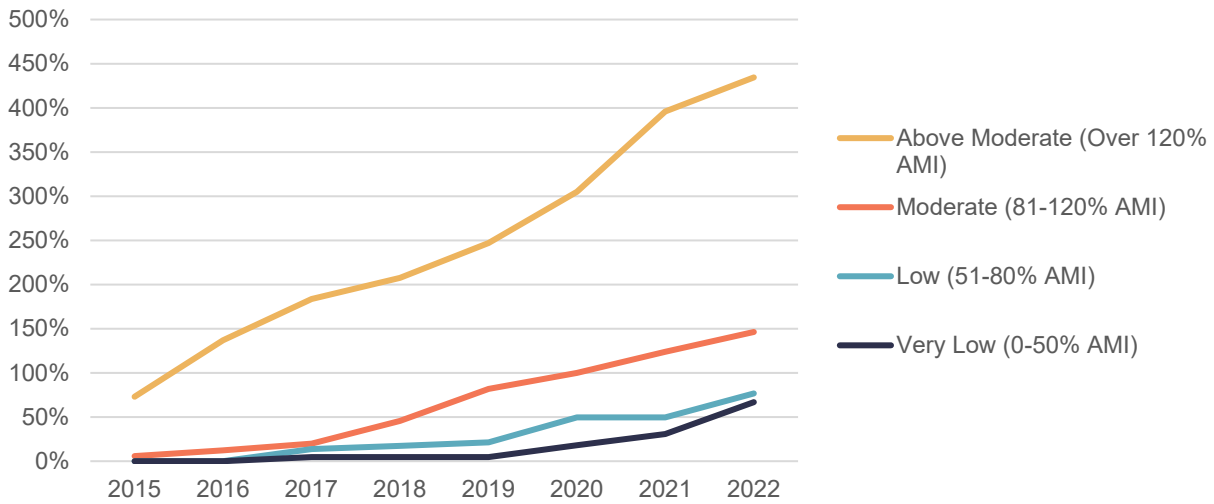
**Figure 2: Housing Growth in Petaluma and Surrounding Jurisdictions**

Jurisdiction	Total Housing Units			% Change 2000-2010	% Change 2010-2019
	2000	2010	2019		
Petaluma	20,304	22,736	23,291	12%	2%
Rohnert Park	15,808	16,551	17,025	5%	3%
Santa Rosa	57,578	67,396	69,406	17%	3%
Sonoma	4,671	5,544	5,778	19%	4%
Sonoma County	183,153	204,572	208,293	12%	2%
<i>Veronica Tam &amp; Associates (2022); ABAG Housing Element Data Package; US Census, 2000 (SF1); 2010 (DP-1) and ACS 5-Year Estimates 2015-2019 (DP05)</i>					

**Petaluma exceeded its RHNA goals for both moderate- and above moderate-income housing for the 2015 to 2023 RHNA planning period, but did not meet its goals for low and very low-income units.** Figure 3 describes the city's cumulative progress towards those goals from 2015 through 2022, based on permitted housing units. During that time, Petaluma met 67 percent of its 2015-2023 RHNA allocation for very low-income households, and 77 percent of its allocation for low-income households through the end of 2022. This left Petaluma approximately 84 very low- or low-income units short of its 2015-2023 RHNA goals with just one month remaining in the RHNA cycle.<sup>3</sup> Housing developers in Petaluma and elsewhere have faced many external challenges and delays over this time period, including COVID supply chain issues, PG&E power installation challenges, and construction cost increases.

<sup>3</sup> The 2015-2023 RHNA cycle ended on January 31<sup>st</sup>, 2023.

**Figure 3: Cumulative Housing Permit Progress Towards Petaluma 2015 to 2023 RHNA Goals, by Year and Income Category (through 2022)**

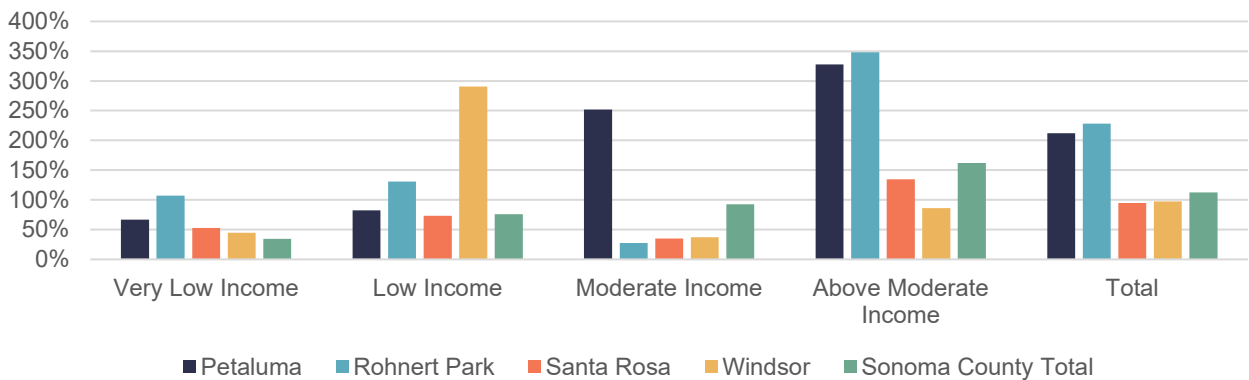


*Note: This figure excludes 6 low-income units, or around six percent of the RHNA target, which were not reported in the City of Petaluma's Housing Element annual updates, but are included in subsequent RHNA figures based on data from ABAG and HCD.*

*Source: City of Petaluma, Housing Element 2021 & 2022 Annual Progress Reports, 2022-2023; Strategic Economics, 2023.*

Relative to 2015 to 2023 RHNA production goals, Petaluma's permit issuances reflected greater progress toward the City's moderate-income goals and approximately the same progress toward very low and low-income goals as Petaluma's Sonoma County peers. This is reflected in Figure 4, which shows progress towards RHNA goals through 2022. Petaluma's housing production trailed Rohnert Park, which met its RHNA goals for all categories except moderate-income households. However, Petaluma achieved a higher share of its RHNA goals across all categories than its Sonoma County peers of Santa Rosa and Windsor.

**Figure 4: Housing Building Permit Progress Towards RHNA Goals in Sonoma County, 2015 to 2022**



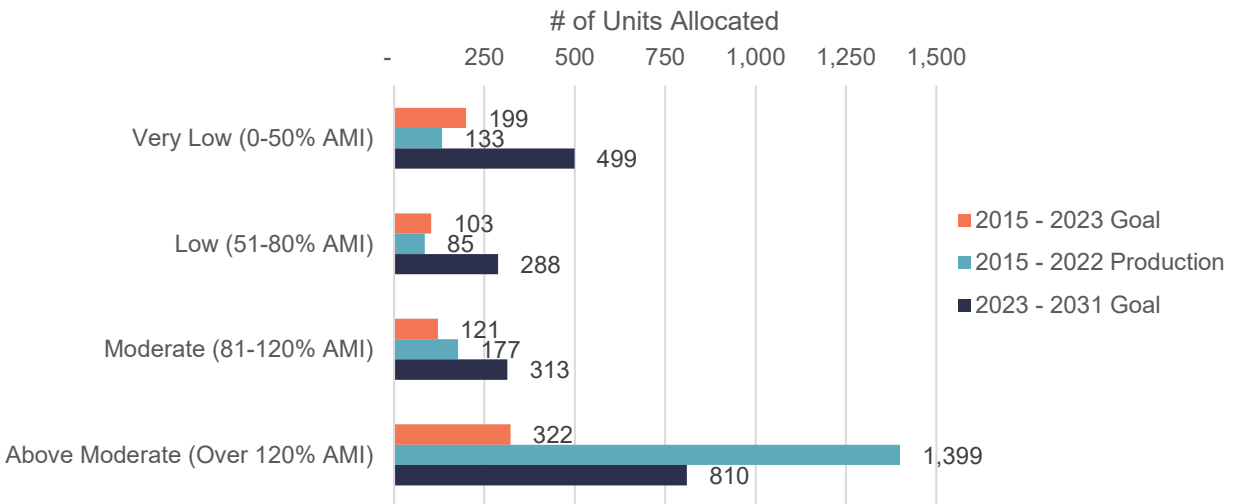
*Source: ABAG, 2015-2020 Bay Area RHNA Progress Report, 2021; HCD, APR Table A2, 2023; Strategic Economics, 2023.*

# Housing Needs

**Petaluma’s affordable housing production goals for the 2023 to 2031 RHNA planning period are even higher than those of the 2015 to 2023 cycle.** In recognition of the housing affordability crisis taking place across the state, HCD increased housing allocations for the current RHNA cycle. Figure 4 shows how Petaluma’s future unit allocations compare to production in the previous RHNA cycle.

**In comparison to its 2015 to 2021 housing production, Petaluma will need to accelerate development of very low, low, and moderate-income housing in order to meet its 2023 to 2031 RHNA goals.** Petaluma could meet its above-moderate income housing goal by maintaining the same historic pace of permitting for units in that income category. However, Petaluma will need to issue building permits for nearly four times as many very low-income units from 2023 to 2031 as it did from 2015 to 2021 in order to meet the city’s new RHNA goal in that category.

**Figure 5: Petaluma 2023 to 2031 RHNA Goals Compared to Prior Goals and Issued Building Permits**



*Source: ABAG, Final Regional Housing Needs Allocation, 2022; HCD, APR Table A2, 2023; Strategic Economics, 2023.*

**High RHNA targets reflect the severity of housing needs and problems that are present in Petaluma and throughout the Bay Area.** Figure 5 describes some of the housing “problems” experienced by Petaluma’s residents, as defined by the U.S. Department of Housing and Urban Development in its annual Comprehensive Housing Affordability Strategy.<sup>4</sup> Over 35 percent of all households in Petaluma are housing cost burdened, meaning that they spend at least 30 percent of their monthly income on housing. Housing cost burden is greater for extremely low, very low, and low-income households, for whom 60 to 72 percent of households are housing cost burdened. In addition,

<sup>4</sup> As described on page 8 of Appendix A of the City of Petaluma 2023-2031 Housing Element, the CHAS housing problems data describes “...four housing problems: incomplete kitchen facilities, incomplete plumbing facilities, more than 1 person per room (overcrowding) and households paying more than 30 percent of their income on housing (cost burden). Severe problems include households paying more than 50 percent of their income on housing (severe cost burden).”

approximately eight percent of renter households are overcrowded – meaning that there is more than one person per room (not including kitchens or bathrooms).<sup>5</sup>

**Figure 6: Housing Problems Experienced by Petaluma Residents, by Income**

Household Income and Housing Problem	Renters	Owners	Total (Owner & Renter)
<b>Extremely Low (<math>\leq 30\%</math> AMI)</b>	1,390	735	2,125
% with any housing problems	65.7%	83.0%	71.8%
% Cost Burden $>30\%$	65.7%	82.9%	71.7%
% Cost Burden $>50\%$	56.3%	76.2%	63.3%
<b>Very Low (<math>&gt; 30\%</math> to <math>&lt; 50\%</math> AMI)</b>	995	920	1,915
% with any housing problems	85.4%	73.4%	79.6%
% Cost Burden $>30\%$	80.9%	79.2%	80.1%
% Cost Burden $>50\%$	60.8%	50.5%	55.9%
<b>Low Income (<math>&gt; 50\%</math> to <math>&lt; 80\%</math> AMI)</b>	1,065	1,300	2,365
% with any housing problems	77.0%	52.3%	63.6%
% Cost Burden $>30\%$	70.4%	49.6%	59.2%
% Cost Burden $>50\%$	34.3%	28.8%	31.5%
<b>Moderate/Above (<math>&gt;80\%</math> AMI)</b>	4,225	11,560	15,785
% with any housing problems	27.9%	22.7%	24.1%
% Cost Burden $>30\%$	25.5%	21.5%	22.6%
% Cost Burden $>50\%$	2.2%	3.7%	3.3%
<b>Total Households</b>	7,975	14,530	22,505
% with any housing problems	47.3%	31.6%	37.1%
% Cost Burden $>30\%$	44.6%	30.7%	35.6%
% Cost Burden $>50\%$	23.2%	12.5%	16.3%
<b>Sources:</b> Veronica Tam & Associates, 2022; HUD, Comprehensive Housing Affordability Strategy (CHAS), 2021. <b>Notes:</b> based on 2014-2018 ACS data			

**Groups with unique housing needs in Petaluma are more frequently cost burdened than the general population.** Approximately 35 percent of Petaluma households have at least one senior, and nine percent of Petaluma residents have a disability (including 24 percent of seniors).<sup>6</sup> While just over one-third of Petaluma households face housing problems; approximately two-thirds of senior and large

<sup>5</sup> Veronica Tam & Associates. (2022). Housing Element Appendix A. Housing Needs Assessment.

<sup>6</sup> Veronica Tam & Associates. (2022). Housing Element Appendix A. Housing Needs Assessment.

family renter households are faced with a housing problem of some kind. The City of Petaluma's Housing Needs Assessment noted that of the eight affordable housing rental developments in Petaluma that are at risk for conversion to market rate housing within the next five years, five developments are targeted to seniors and two are targeted to people with disabilities.<sup>7</sup>

**Figure 7: Housing Cost Burdens and Housing Problems for Seniors and Large Families**

	Renters		Owners	
	Seniors	Large Families	Seniors	Large Families
<b>Total Households</b>	1,685	925	5,545	980
% with any housing problems	66.2%	65.9%	33.9%	48.5%
% Cost Burden >30%	63.1%	60.0%	33.9%	34.1%
% Cost Burden >50%	37.3%	23.8%	14.9%	15.2%
<i>Source: Veronica Tam &amp; Associates, 2022; U.S. Census, American Community Survey 5-Year Data, Table B25014 (2015-2019).</i>				

<sup>7</sup> Veronica Tam & Associates. (2022). Housing Element Appendix A. Housing Needs Assessment, p A-31.

# Funding Opportunities and Barriers for Affordable Housing Development

Strategic Economics analyzed current funding mechanisms and local funding availability for supporting affordable housing development projects that will help meet Petaluma’s affordable housing needs. Meeting the RHNA targets assigned to Petaluma for the 2023 to 2031 planning period will require the City of Petaluma to enhance affordable housing funding and financing opportunities.

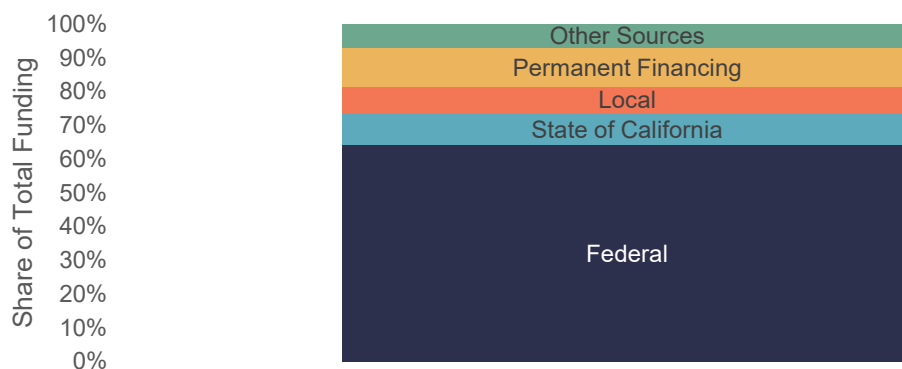
This section describes the current landscape for affordable housing funding in Petaluma and analyzes examples from recent deed-restricted affordable housing projects to identify how developers currently fund these affordable units in Sonoma County. The section also identifies funding barriers in Petaluma and opportunities for improvement in the local funding landscape based on the analyses and on qualitative input provided by local housing developers interviewed for this study.

The funding opportunity and barriers analysis focuses primarily on the mechanics of funding and financing a “100 percent affordable” deed restricted housing project, as opposed to “inclusionary” affordable units in an otherwise market rate development project. However, the analysis also examines the implications of inclusionary policies for providing local funding for affordable housing development projects.

## How 100 Percent Affordable Housing Projects are Funded

**Affordable housing projects are most often funded by stitching together a complex array of subsidies and financing sources.** In market rate housing development, developers must find a way to ensure that land costs, construction costs, other development costs, and investment return are lower than the market value of the project—driven by the rents or sales prices it will ultimately be able to command. In 100 percent affordable projects, the end market value is lower due to the restricted rents or sales prices, meaning that a gap exists between what a development costs to build and the amount of rent or sales revenue it will return. Subsidies help cover the gap between the cost of building or acquiring housing and what lower income households can afford to pay.

**Figure 8: Typical Funding Sources for Affordable Projects in Petaluma, 2020-2021**



Source: California Tax Credit Allocation Committee, 2020-2021; Strategic Economics, 2023.



**The level of subsidy needed to cover the gap between development costs and affordable rent or sales price revenues depends on the level of affordability being provided, with units serving extremely low-income households requiring the most subsidy.** Consequently, nearly all available funding sources at the federal, state, and local levels serve low income households earning up to 80 percent of Area Median Income (AMI) or below. Very few sources are available for moderate- and middle-income households (earning up to 120 percent of AMI and approximately 150 percent of AMI, respectively).

**Equity investments generated via the Low Income Housing Tax Credit (LIHTC) program typically account for the largest source of subsidy for affordable housing production.** The LIHTC program is a federal tax subsidy that gives investors a roughly dollar-for-dollar credit on their tax liability in exchange for equity contributions to subsidize affordable housing development projects. The level of investment received depends on the type of LIHTC program utilized by the project. The nine percent credit provides a higher level of funding but is traditionally more difficult to obtain than the four percent credit, which is typically paired with tax-exempt bonds to provide project subsidies.

**In addition to this LIHTC equity, developers may fill gaps in funding using other federal, state, or local sources of financing.** Much of this funding comes from the federal government, but is administered by state or local governments. Nationwide, the federal government funded approximately two-thirds of state and local housing and community development programs in 2019.<sup>8</sup> A variety of these state and federal sources are shown in Figure 9, while local sources are shown in Figure 11. Examples of federal and state programs include the State of California's Affordable Housing and Sustainable Communities (AHSC) grants, federal HOME funds, and the Federal Home Loan Bank of San Francisco's Affordable Housing Program (AHP).

**Each source of affordable housing funding comes with its own set of requirements, application processes, and prioritization criteria.** Affordable housing developers must navigate this complex web of federal, state, and local requirements to compile enough funding to execute their projects. In addition, the funding landscape changes over time, creating new challenges for developers who may no longer be able to use funding sources in the same way as in previous projects. In this context, local sources of funding may provide greater flexibility for affordable housing developers to finance their projects and secure access to land.

**The ability to leverage federal and state sources is often contingent on the availability of additional local subsidies.** Some examples of local funding sources include commercial linkage fees, housing in-lieu fee programs, community land trusts, and locally-administered programs that utilize state or federal funding, such as Permanent Local Housing Allocations and Community Development Block Grants. Figure 11 explains each of these funding sources and others that are currently available to developers in Petaluma.

## State and Federal Funding Sources

**State and federal government programs together provide a wide variety of affordable housing funding sources, but these programs often prioritize site or project-specific assets that are not necessarily common in Petaluma.** Figure 9 lists examples of project and location-specific priorities.

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<sup>8</sup> Urban Institute (2021). State and Local Backgrounders: Housing and Community Development Expenditures. Retrieved from: <https://www.urban.org/policy-centers/cross-center-initiatives/state-and-local-finance-initiative/state-and-local-backgrounders/housing-and-community-development-expenditures>

Many of these programs prioritize amenities such as access to transit, jobs, or other resources. Many areas in Petaluma are unable to score well on these factors when compared against other locations throughout the region or state. Programs are also often specifically targeted to certain population groups or use the population groups targeted by a project as a tiebreaker when deciding between two similarly scored applications. As an example, local affordable housing developers interviewed for this study noted that senior housing projects have become less competitive for attracting funding in recent years because the state is focused on incentivizing large family developments. Senior projects also do not score as highly for Affordable Housing and Sustainable Communities Program (AHSC) awards since the AHSC criteria prioritize housing projects that result in greater greenhouse gas reductions.

**Competition for many state and federal affordable housing programs is increasing.** Competition for nine percent LIHTC credits has always been strong. In contrast, four percent credits were once relatively accessible since they are automatically awarded in conjunction with allocations of tax-exempt private activity bonds. The bonds are allocated on a regional basis, as determined by CDLAC, and capped for each region. High demand and strong competition now exist for private activity bond allocations and the associated ability to receive four percent tax credit awards, creating a further funding challenge for affordable housing developers.

**The State of California's scoring priorities for LIHTC may make it more difficult for projects in Petaluma to win funding.** TCAC and CDLAC apply similar criteria for awarding tax credits and tax-exempt bonds for affordable housing development projects. TCAC's scoring process awards some of its points based on the presence of specific site location characteristics, including surrounding amenities. The nine percent LIHTC scoring system, for example, rewards sites that are in close proximity to transit amenities, public parks, libraries, and grocery stores, among other resources. As a result, many potential affordable housing sites in Petaluma would not necessarily be positioned to score well for attracting these tax credits.

**Figure 9: Examples of Major State and Federal Affordable Housing Development Funding Sources**

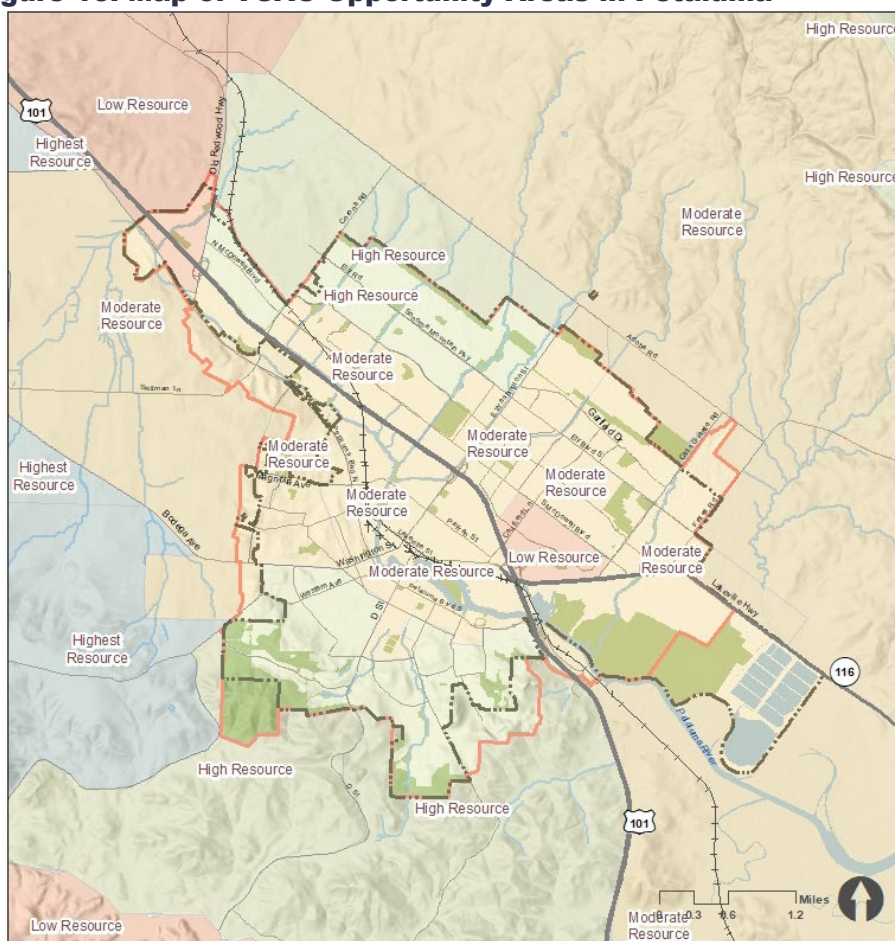
Program	Description	Agency that Administers Funding	Key Site-Specific Requirements for Funding Eligibility
<b>9% Low Income Housing Tax Credit (LIHTC)</b>	Federal and state tax credits that allow developers to leverage private equity for affordable housing development.	TCAC	Prioritizes allocation of tax credits in “high-resource” areas
<b>4% Low Income Housing Tax Credit (LIHTC)</b>	Federal and state tax credits that allow developers to leverage private equity and tax-exempt, multi-family bonds for affordable housing development.	TCAC, CDLAC	Prioritizes allocation of tax credits in “high-resource” areas
<b>Section 8 (Housing Choice Vouchers and Project-Based Vouchers)</b>	Federal rental assistance program that provides rental payments directly to landlords. Section 8 can also be allocated on a project-by-project basis to support affordable housing development.	HUD, via Sonoma County Housing Authority	None
<b>HOME Investment Partnerships Program</b>	Federal block grants to states and local governments that can be used to support a wide variety of affordable housing efforts.	HUD, via State of California	None
<b>HOME-American Rescue Plan Program</b>	Federal grants to states for addressing homelessness and supporting vulnerable populations through rental assistance, affordable housing development, and supportive services. The State of California anticipates receipt of funds in Spring of 2023.	HUD, via State of California	Criteria under development
<b>Community Development Block Grant (CDBG)</b>	Federal block grants to states and local governments for community and economic development activities, including affordable housing preservation and production	HUD	None
<b>Federal Home Loan Bank Affordable Housing Program (AHP)</b>	Each Federal Home Loan Bank is required to contribute 10 percent of its earnings towards funds for affordable housing construction or rehabilitation.	Federal Home Loan Bank of San Francisco	None
<b>Permanent Local Housing Allocation</b>	State program that provides funding for local governments to support housing projects and programs.	CA HCD, via City of Petaluma	None

Program	Description	Agency that Administers Funding	Key Site-Specific Requirements for Funding Eligibility
<b>No Place Like Home</b>	This state program provides funding for development of permanent supportive housing for people who need mental health services and are experiencing homelessness.	CA HCD	None
<b>Joe Serna Jr. Farmworker Housing Grant</b>	Deferred payment loans to fund construction, rehab, or acquisition of housing units for agricultural workers, with priority for low-income households.	CA HCD	None
<b>Multifamily Housing Program (MHP)</b>	Deferred payment loans to assist affordable housing development focused on permanent and transitional rental housing for lower income households.	CA HCD	None
<b>Infill Infrastructure Grant Program (IIGP)</b>	Grants available as gap financing for capital improvement projects that support infill housing development.	CA HCD	The project must be a Qualifying Infill Project or located in a Qualifying Infill Area. The site must have previously been developed, or be surrounded on 75% of its perimeter by developed sites.
<b>Affordable Housing and Sustainable Communities (AHSC)</b>	Grants and loans available through the state's cap-and-trade program; funds projects that support compact development and active transportation, and reduce greenhouse gas emissions.	CA HCD (Strategic Growth Council)	For projects in TOD Project Areas, development site must be within a half-mile watershed of high-quality transit (i.e., rail or BRT service with headway frequency of 15 minutes or better).
<b>Local Housing Trust Fund (LHTF)</b>	Provides matching funds to local and regional housing trust funds. Funds can be used for development, rehabilitation, or preservation of affordable housing units, transitional housing, or emergency shelters.	CA HCD	None
<b>CalHFA ADU Grant Program<sup>9</sup></b>	Provides up to \$40,000 for pre-development and closing costs incurred with the construction of an ADU. Available to moderate or low-income homeowners.	CalHFA	None
<b>CalHFA Mixed-Income Program (MIP)</b>	Long-term subordinate financing for new affordable multifamily projects. Targeted to income levels between 30% and 120% AMI.	CalHFA	None
<b>Sources: California Legislative Information, 2022; Myers Nave, 2017, 2021; California, HCD, 2023; Strategic Economics, 2023.</b>			

<sup>9</sup> All funds for this program were fully committed as of March 1, 2023.

**Affordable housing development projects in Petaluma may struggle to achieve high scores for some state funding sources due to the City’s relatively limited transit amenities and lack of block groups that are designated as “Highest Resource” areas.** This “Highest Resource” designation comes from TCAC’s methodology for rating each census block group according to its access to resources such as jobs, home values, and education. TCAC uses this rating system as a tiebreaker, giving bonus points to projects that are located in “High Resource” or “Highest Resource” areas of the state. This prioritization is driven by the State of California’s Affirmatively Furthering Fair Housing (AFFH) goals to reduce segregation and provide equitable opportunities for residents. Figure 10 shows the opportunity area designations in Petaluma, with “High Resource” areas shown in the northern part of East Petaluma and the southern part of West Petaluma. As shown on this map, the majority of Petaluma is considered a moderate resource area, and not eligible for bonus points in project applications. The area in Petaluma with the best transit amenities, the Downtown SMART station, is in a “Moderate Resource” community.

**Figure 10: Map of TCAC Opportunity Areas in Petaluma**



Data Sources: City of Petaluma (2021); County of Sonoma (2021); ESRI (2021); TCAC (2022).





## Local Funding Sources and Conditions

**Local funding sources are an important competitive advantage for affordable housing developers seeking to obtain the largest sources of affordable housing financing, such as LIHTC.** One of the State of California's primary tiebreakers in awarding LIHTC funding is the total amount of leveraged resources, such as public funds, loans, or donated land.<sup>10</sup> Historically, redevelopment funding in California was a major source of locally controlled funding to invest in affordable housing projects. The state's elimination of redevelopment agencies in 2012 left a gap in funding that has only recently been replaced with surplus state and federal funds.<sup>11</sup> While expansion of state-level housing investments could be potentially beneficial for affordable housing development in Petaluma, local developers interviewed for this study emphasized the need for local funding to compete for these state and federal sources.

**Petaluma is well-positioned to generate local funding resources as development occurs, with the City having enacted commonly adopted local funding mechanisms for affordable housing production and preservation.** For example, Petaluma has a Commercial Development Housing Linkage Fee that applies to new development of retail, industrial, and other commercial projects. The City also maintains an Inclusionary Housing program, which generates housing in-lieu fees from developers who do not build the required affordable housing units on-site. Figure 11 describes these and other local sources in Petaluma.

**Overall local affordable housing funding sources are relatively limited in Petaluma and Sonoma County due to a slower overall pace of development activity and few funding measures that set the City and County apart from neighboring regions.**<sup>12</sup> Both local developers and housing advocacy organizations reported that Petaluma has comparatively very little local funding available to subsidize development of affordable housing. Ballot measures in Sonoma County communities for creating local housing funds, such as a 2018 bond measure in Santa Rosa, have failed.<sup>13</sup> There are a few county-level funding sources (described in Figure 11) for either affordable housing development or the development of ADUs, but funds for each of these sources are limited. As an example of tax-funded initiatives occurring elsewhere, Alameda County enacted a housing bond that allocates millions of dollars for rental housing development across the county's jurisdictions. Cities such as Dublin, Newark, or Union City are receiving between \$5 million and \$9 million in dedicated funds from this initiative.<sup>14</sup> Affordable housing developers in Sonoma County noted that the limited local funding impacts new affordable housing development in Petaluma, to the extent that developers are sometimes reluctant to pursue projects in Petaluma specifically because of the lack of local funding. However, recent funding changes may be improving this situation for affordable housing developers in Petaluma.

**The City of Petaluma is proactively seeking and implementing opportunities to expand the utility of the City's housing funds and contributions.** In November of 2021, the City Council issued a

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<sup>10</sup> California Tax Credit Allocation Committee. (2021). Regulations Implementing the Federal and State Low Income Housing Tax Credit Laws.

<sup>11</sup> Baird + Driskell Community Planning (2019). Housing Funding Trends & Resources in Sonoma County. Published by Generation Housing.

<sup>12</sup> Baird + Driskell Community Planning. (2019). Sonoma County Housing Policy Scan. Published by Generation Housing.

<sup>13</sup> MAP One Sonoma County. (2020). Sonoma County Housing 101: A Toolkit for Understanding and Tackling Sonoma County's Housing Shortage.

<sup>14</sup> Alameda County Housing & Community Development Department (2021). Alameda County Measure A1 Funding by City – Base City Allocation. Retrieved from: [acgov.org/cda](https://acgov.org/cda)

resolution empowering the Housing Manager to establish the City’s Local Housing Trust Fund, which aggregates revenues from the City’s Inclusionary Housing in-lieu fees, commercial linkage fees, and Permanent Local Housing Allocation funds (see Figure 11 for details). A Local Housing Trust Fund is required by California HCD to compete for matching funds for affordable housing preservation and development. The Trust Fund allows the City to provide local matching funds that amplify opportunities for affordable housing developers to obtain outside funding. In March of 2022, the City received an award from the HCD’s Homekey program to fund 60 permanent supportive housing units.<sup>15</sup> Lastly, the Petaluma City Council passed a resolution in November of 2022 to exempt deed-restricted affordable housing projects from the City’s facilities, parkland, traffic, and open space impact fees. While not a direct funding source, this fee waiver can qualify as a local funding match for many external funding applications.

**Figure 11: Local Funding Sources**

Program	Source	Description
<b>Sonoma County CDC Permanent Local Housing Allocation</b>	CA HCD, via City of Petaluma	Provides funding for local governments to support housing projects and programs.
<b>Sonoma County Fund for Housing</b>	County of Sonoma	Provides loans and grants to qualified developers to expand affordable housing throughout Sonoma County.
<b>Redwood Credit Union ADU Lending Program</b>	Napa Valley Community Foundation & Redwood Credit Union	ADU construction loan available to homeowners developing ADUs.
<b>Sonoma County Housing Fund</b>	Housing Trust Silicon Valley & Santa Rosa Metro Chamber	Provides loans for affordable housing development, funded by a 2-1 match between the Housing Trust and local investors.
<b>Commercial Linkage Fee</b>	City of Petaluma	Provides funding for housing by leveraging fees on commercial development. Funding in 2022 was allocated to the Sonoma County Housing Land Trust and administrative costs to housing.
<b>Housing In-Lieu Fees</b>	City of Petaluma	Funds generated by market rate developers in lieu of providing inclusionary housing. 2022 Funds went to Petaluma People Services, COTS, and Veterans Res Ctr as well as administrative costs to housing.
<b>CDBG</b>	Federal, via City of Petaluma	Federal funds that can be used to fund rehabilitation, homeownership assistance, or site costs associated with housing development.
<b>HOME/Begin Grants</b>	Federal, via City of Petaluma	Federal funds administered by local communities to support housing construction or rental assistance
<b>Successor Agency Housing</b>	City of Petaluma	Includes homelessness support. Successor to PCDC.
<b>Mobile Home Rent Stabilization</b>	City of Petaluma	This fund covers administrative costs of enforcing rent increase limits for Petaluma mobile homeowners. Rent increases cannot exceed the annual rate of inflation.
<i>Sources: County of Sonoma, 2022; City of Petaluma 2021; Housing Trust Silicon Valley, 2019; Napa Sonoma ADU, 2022.</i>		

<sup>15</sup> City of Petaluma. Project Homekey Press Release, 2022.

## Funding Gap for Affordable Housing

Strategic Economics examined the typical “funding gap” that must be filled by local city and county affordable housing contributions to deliver affordable housing units via 100 percent affordable development projects. This funding gap indicates the magnitude of required affordable housing funding to ensure projects continue to be built. Comparison with other communities indicates the extent to which funding gap contributions lag or exceed other communities’, which helps to determine the ability to compete for outside funding by providing an adequate local funding match.

The funding gap analysis included review of pro forma financial statements to document average per-unit development costs and the usage of local city and county funding for 23 recent LIHTC projects in Sonoma County. The analysis was based on countywide projects due to the limited number of recent LIHTC projects in any individual municipality—including just two tracked projects in Petaluma.

## Affordable Housing Development Costs

**Affordable housing developers estimated that the average development cost per affordable housing unit in Petaluma in 2022 was just under \$700,000.** Figure 12 provides average costs based on two LIHTC applications for affordable housing development projects in Petaluma, and 21 others throughout Sonoma County between 2020 and 2021. This figure shows that average development costs are higher in Petaluma than elsewhere in Sonoma County—a finding that was reiterated in interviews by affordable housing developers. Among these projects, the biggest share of cost was hard costs, such as materials, construction contracting, relocation expenses, and construction contingency.

**Affordable housing developers noted that increasing land costs are an ongoing challenge in Sonoma County.** Local affordable housing developers interviewed for this study noted difficulties in acquiring sites at supportable land costs, especially given the limited local resources for supporting affordable housing development since the dissolution of redevelopment agencies. As shown in Figure 12, land acquisition costs constituted seven percent of the average total development cost per affordable housing unit in Petaluma from 2020 to 2021.



**Figure 12: Average Development Costs per Unit for Affordable Housing Projects in Sonoma County, 2020 to 2021**

	Average Per Unit Costs, All Sonoma County Projects	Average Per Unit Costs, Petaluma Projects	Average Share of Total, Petaluma Projects
Land Acquisition Costs	\$42,000	\$44,000	7%
Hard Costs (Including Contingency and Relocation)	\$317,000	\$445,000	67%
Soft Costs	\$49,000	\$70,000	11%
Developer Fees	\$44,000	\$54,000	8%
Other	\$48,000	\$53,000	8%
<b>Total</b>	<b>\$500,000</b>	<b>\$666,000</b>	<b>100%</b>
<p><b>Notes:</b>  Cost estimates come from 23 different TCAC applications submitted by projects in Sonoma County in 2020 and 2021. Two of these projects were in Petaluma: River City Senior Apartments and 414 Petaluma Blvd.  “Other” includes unspecified reserves and costs, including development impact fees.  As of November 2022, affordable housing projects in Petaluma are exempt from most impact fees—resulting in a substantial reduction of “Other” costs. Average costs shown here do not reflect this change. Per unit totals differ slightly from Figure 13 because some funding figures were reported separately by developers.  Source: California Tax Credit Allocation Committee, 2020-2021; Strategic Economics, 2023.</p>			

## Affordable Housing Funding Sources

Typical affordable housing projects in Sonoma County obtain most of their funding from tax credits (LIHTC), with very little funding from local sources. Figure 13 shows average shares of funding for the 23 affordable housing LIHTC projects reviewed in this analysis. Tax credits accounted for nearly all of the 60 percent of financing that the Sonoma County projects received from federal sources. An additional 13 percent of funding came from the State of California, through programs such as the Mixed Income Program and the California Housing Finance Agency’s permanent loans. Another 16 percent came from permanent financing, such as conventional loans and Section 8 loans.

City or County funding accounted for an average of just eight percent of the total funding mix for LIHTC projects in Petaluma, and five percent of funding for all Sonoma County projects from 2020 to 2021. The largest local funding sources were land donations provided by market rate developers to meet inclusionary housing program requirements. In addition, several affordable housing developers used local in-lieu fee funds and Sonoma County’s Fund for Housing. Across each of the 23 projects considered for this analysis, no project received a city funding share greater than 24 percent of total development costs.

**Figure 13: Average Funding per Unit for Affordable Housing Projects in Sonoma County, 2020 to 2021**

	Average Per Unit Funding, Sonoma County	Average Per Unit Funding, Petaluma Projects	Average Share of Total Funding, Petaluma Projects
Federal (including LIHTC)	\$299,000	\$438,000	64%
State of California	\$64,000	\$65,000	10%
Local (City or County)	\$25,000	\$54,000	8%
Permanent Financing	\$82,000	\$79,000	12%
Other Sources	\$32,000	\$47,000	7%
<b>Total</b>	<b>\$502,000</b>	<b>\$683,000</b>	<b>100%</b>
<p><i>Note: Numbers are rounded to the nearest \$1,000. Numbers differ slightly from costs because some funding figures were reported separately by affordable housing developers.</i></p> <p><i>Funding estimates come from 23 different TCAC applications submitted by projects in Sonoma County in 2020 and 2021. Two of these projects were in Petaluma: River City Senior Apartments and 414 Petaluma Blvd.</i></p> <p><i>Source: California Tax Credit Allocation Committee, 2019-2021; Affordable Housing Developers, 2022; Strategic Economics, 2022.</i></p>			

**In comparison to other Bay Area jurisdictions, affordable housing projects in Petaluma and Sonoma County receive a smaller share of funding from local sources.** Figure 14 compares the local funding share for four-percent and nine-percent LIHTC projects in Petaluma with results for projects in San Francisco and Santa Clara County—jurisdictions for which Strategic Economics previously completed similar funding analyses. Although the years covered by the analyses vary slightly, the results show that affordable housing developers in San Francisco and Santa County received 27 percent to 37 percent of their project funding from local sources. In contrast, only three percent to seven percent of funding came from local sources for projects in Sonoma County. Differences in funding ability should be expected between Sonoma County and communities in more populous and better-resourced counties. However, the stark contrast in funding availability between Petaluma and other locations indicates the level of competition Petaluma may face in attracting affordable housing developers—who can operate in areas throughout the Bay Area.

**The low share and amounts of local funding provided to LIHTC projects in Sonoma County suggest a need to enhance local affordable housing funding sources.** Affordable housing developers interviewed for this study noted relatively limited availability of local affordable housing funding sources in Sonoma County communities compared to other Bay Area locations.<sup>16</sup> The LIHTC development project data supports this assertion, given the relatively low shares and dollar amounts of funding provided to the projects analyzed. Limited local funding amplifies challenges for affordable housing developers by creating a need to compete for larger quantities of other funding sources while being less able to obtain funding from sources that require or prefer local funding matches.

<sup>16</sup> Interviews with local affordable housing developers were conducted prior to November 2022, when the Petaluma City Council passed a resolution exempting affordable housing projects from some development impact fees. Such a resolution could help reduce local funding gaps, up to a maximum of 10 percent of total housing development costs.

**Figure 14: Local (City and County) Share of Total Funding, Petaluma LIHTC Projects Versus Santa Clara and San Francisco County LIHTC Projects**

Location	Years	Local Funding Share of Total Cost
<b>LIHTC Projects in Petaluma</b>		
Petaluma – All	2020-2021	8%
Petaluma - 4% LIHTC	2020-2021	11%
Petaluma - 9% LIHTC	2020-2021	6%
<b>LIHTC Projects Comparison Estimates</b>		
Santa Clara County - 4% LIHTC	2016-2020	27%
Santa Clara County - 9% LIHTC	2016-2020	37%
Santa Clara County - All	2016-2018	30%
San Francisco - All	2015-2018	37%
<p><b>Note:</b>  Numbers are rounded to the nearest \$1,000  Comparison counties were selected based upon areas for which analysis was available; although these counties' contexts and circumstances differ from Petaluma and Sonoma County, they demonstrate the challenges in competing for affordable housing development and investment given differences in local funding resources.  Source: California Tax Credit Allocation Committee, 2019-2021; Strategic Economics, 2022.</p>		

## Future Local Funding Gap Estimate

**Petaluma will require expanded local affordable housing funding resources to meet the City's current 6<sup>th</sup> cycle RHNA targets.** Petaluma is targeting production of at least 787 housing units affordable to households at or below low-income levels (80 percent of AMI) between 2023 and 2031. As previously shown in Figure 13, LIHTC projects in Petaluma received an average of eight percent of total funding from local city and county funding sources. In order to provide a comparable local funding contribution for 787 future affordable housing units provided solely through 100 percent affordable housing projects, the City and County would need to provide at least \$43.0 million, or approximately \$5.3 million annually. This is approximately twice the current amount of locally raised revenues that the City of Petaluma is projecting for the 2021/2022 fiscal year (based on the sources shown in Figure 11). In addition, affordable housing developers in the city struggled to obtain sufficient state and federal funding to meet much lower production targets in the previous RHNA cycle. If the City and County were to contribute a share of funding to each project comparable to some other Bay Area communities, such as 25 percent, they would need \$134.4 million in total funds over the next eight years. This would translate to \$16.8 million annually, a figure much higher than the current available funding. While the City's recent reductions to impact fees for affordable housing could help to close this funding gap, more funds would still be needed to achieve such a large increase in local funding.

## Leveraging Market Rate Development to Support Affordable Housing Funding and Production

**Petaluma's inclusionary housing policy will also contribute toward meeting the City's affordable housing goals.** The illustrative funding gap analysis demonstrated the overall magnitude of local funding required to ensure production of affordable housing units delivered via 100 percent affordable LIHTC housing projects. However, a variety of approaches will continue to be used to deliver affordable housing units in Petaluma. Petaluma's inclusionary housing policy requires developers of projects with more than four housing units to dedicate at least 15 percent of the units to low- or very low-income households for rental projects, or to low- and moderate-income households for ownership projects. In recent years, the City of Petaluma has been encouraging developers to build these units on-site and integrated into the rest of the development, rather than using alternative means of compliance such as in-lieu fees. This limits the City's overall pool of housing funding but allows for affordable units to be produced without using public subsidy.

**Accessory Dwelling Units (ADUs) may be another means of using market rate housing production to deliver units that may be affordable to moderate-income households.** While not all ADUs produced in Petaluma will be affordable to households at 120 percent of AMI or below, the City's existing pipeline of project permits indicates at least some recently approved ADUs are expected to be affordable to moderate income households. Some local sources of finance are available to support the development of future ADUs in the region, such as the Redwood Credit Union ADU Lending Program, but the pool of funding available for this program is limited. Thus, additional local support may be needed in the future to sustain resources for development of ADUs as a relatively affordable (though not deed-restricted) source of housing.

# Regulatory and Policy Environment for Affordable Housing Production

Strategic Economics reviewed current federal, state, and local housing regulations to identify how the current policy context is constraining and supporting affordable housing development. The regulatory environment at a federal, state, and local policy level can create both challenges and opportunities for local development. State or federal policy changes can impact development by altering the funding landscape or incentivizing new types of housing projects. Meanwhile, local regulations can both constrain development processes and provide new opportunities for development without additional public expenditures.

This section provides a review of recent trends in regulations at the local, state, and federal levels, highlighting opportunities for Petaluma to increase housing production and meet its affordable housing needs. The review incorporates consideration of policies impacting production of 100 percent affordable housing development projects as well as market rate housing, since the latter is linked to affordable housing production via Petaluma's inclusionary and in-lieu fee requirements.

## Federal and State Policy Context

**Recent actions at the federal level primarily affect Affirmatively Furthering Fair Housing Requirements and some funding sources.** Since the beginning of 2021, the U.S. Department of Housing and Urban Development has restored interpretations of the Affirmatively Furthering Fair Housing (AFFH) Act that require certifications of fair housing and prohibit discrimination on the basis of sexual orientation; added additional climate change mitigation and equity constraints to federal disaster-relief block grants;<sup>17</sup> and created the House America program with American Rescue Plan funding. This program uses federal funding resources to create new permanent supportive housing and re-house individuals experiencing homelessness with a housing-first approach.<sup>18</sup>

**In addition, in May of 2022, the Biden-Harris Administration announced a Housing Action Plan that in many ways mirrors housing policies that have been created in California in recent years.**<sup>19</sup> These policies focused on loosening restrictions on housing production and making it easier for non-profits and homeowners to develop types of housing that increase density or are more naturally affordable. Some of the action items were as follows:

- Give jurisdictions that complete land-use and zoning reforms higher scores in their applications for federal grants.
- Provide additional financing for development of manufactured housing, ADUs, and 2-4 unit properties.
- Provide more flexibility and streamlined processes for federal funding programs such as HOME and LIHTC.

<sup>17</sup> Kahlif, A. (2022). Associated Press. HUD Prioritizes Climate Change Mitigation, Economic Equity in Block Grants.

<sup>18</sup> HUD (2021). Retrieved from: [https://www.hud.gov/house\\_america/goals](https://www.hud.gov/house_america/goals)

<sup>19</sup> The White House (2022). President Biden Announces New Actions to Ease the Burden of Housing Costs. Retrieved from [Whitehouse.gov/BriefingRoom](https://www.whitehouse.gov/BriefingRoom)

- Prioritize non-profits and owner-occupants over institutional investors in the sale of government-owned homes.

**At the State of California level, recent legislation has sought to increase opportunities for affordable and market-rate developers to provide housing, by reducing zoning restrictions and streamlining approval processes.** Figure 15 summarizes major housing legislation in California from 2017 through 2022. Among these policies, AB 1505 provided a framework for cities to institute inclusionary housing ordinances; AB 1397 and SB 35 provided various means of streamlining project approvals for affordable housing; AB 68 eased the approval process for ADUs; SB 9 has enabled property owners to potentially quadruple the number of units on a single-family property; and several bills passed in 2022 have enabled residential development on commercially zoned land.

**Despite this wave of recent legislation, local Petaluma developers indicated that the impacts of recent State policies on their development practices were limited.** Market rate housing developers expressed that some recent policies provided new paths for local approval of their projects, but they would still prefer more opportunities for streamlined approvals processes. Meanwhile, several affordable developers indicated that the usefulness of SB 35 is limited by the increased costs associated with its prevailing wage requirements. Lastly, there is some evidence that recent state policies have resulted in increased production of ADUs, but this was not a central area of focus for most local housing developers.

**Figure 15: State of California Major Housing Legislation Enacted 2017 to 2022**

Legislation	Year Enacted	Description
AB 1397	2017	Adds greater specificity around what communities are required to do to identify and make sites available for production in their housing elements.
AB 1505	2017	Allows local governments to adopt inclusionary housing ordinances for rental housing. However, it restricts the intensity of those requirements for jurisdictions that are not meeting their RHNA goals.
AB 72 - Housing Accountability Act	2017	Using HCD review, holds jurisdictions accountable for accomplishing the goals they establish in their housing elements.
AB 73 - Housing Sustainability Districts	2017	Incentivizes the creation of housing sustainability districts to encourage housing production on infill sites near public transit. Provides options for streamlined approval of on-site affordable housing.
SB 35 - Streamlined Affordable Housing	2017	Requires local municipalities to streamline the approval of certain housing projects via ministerial approval, elimination of CEQA analysis and other entitlements. Only applies to cities that are not meeting their RHNA goals.
AB 2162 - By Right Supportive Housing	2018	Requires that supportive housing is permitted in multifamily or mixed-use development zones. Provides for ministerial review of a minimum amount of supportive housing.
SB 167	2018	Imposes stricter standards for approval of housing proposals and harsher penalties for jurisdictions that violate the Housing Accountability Act.
AB 1486 - Surplus Lands Act	2019	Requires local agencies to give notice about available public land to affordable housing developers.
AB 68	2019	Expanded the types of ADUs and JADUs that could be ministerially approved. Eliminated owner-occupancy requirements for ADUs and changed what local jurisdictions could restrict via ordinances for ADUs.

Legislation	Year Enacted	Description
SB 330 – Housing Crisis Act	2019	This bill establishes a statewide housing emergency to be in effect until January 1, 2025. It limits what jurisdictions can do to review developments using non-objective standards or cap the number of housing permits. It also requires 1-1 replacement when demolishing units and tenant protections associated with new construction.
AB 2345 - State Density Bonus Law Amendment	2020	Offers incentives to projects that provide on-site affordable housing. Projects that provide affordable housing or support a specific population (such as seniors) can seek up to 50% additional density or receive other benefits.
SB 13	2020	Established statewide requirements and approval pathways for ADUs.
AB 1398	2021	Requires that local government rezone within one year if their housing element is not compliant with state law.
AB 602	2021	Requires local jurisdictions to be more transparent about how they calculate or increase impact fees assessed on housing.
SB 10	2021	Allows local jurisdictions to re-zone parcels for up to 10 units if they are "transit rich" or "urban infill" without requiring CEQA review of the zoning change.
SB 478	2021	Creates minimum floor-area-ratios for "missing middle" multifamily units. Projects with 3 to 7 units must have 1.0 FAR; projects with 8 to 10 units must have at least 1.25 FAR.
SB 9 - California HOME Act	2021	Allows property owners to build up to four units on any parcel zoned for single family homes. These projects are required to be approved ministerially.
AB 2221	2022	Expands and clarifies ADU location and approval requirements.
SB 6	2022	Allows residential uses on commercially zoned property without rezoning if labor requirements are met.
AB 2011	2022	Provides pathway for ministerial approval of residential developments on commercially zoned land for projects meeting affordability targets.
AB 2097	2022	Prohibits parking minimums within half a mile of public transit
<b>Sources: California Legislative Information, 2022; Holland &amp; Knight, 2022; Myers Nave, 2017, 2021; Strategic Economics, 2022.</b>		



## Local Regulatory and Policy Context

Strategic Economics interviewed local affordable housing and market rate housing developers with experience in Petaluma to gather input on the impact of local regulations and policies in promoting or constraining affordable housing production. Topics included parking, retail requirements, and other regulations impacting production of affordable housing projects and market rate housing projects that provide affordable units or funding via local inclusionary requirements.

**Developers of affordable housing generally prefer reduced parking ratios to reduce construction costs, although market rate housing developers emphasize the need to provide sufficient parking to support project desirability and associated higher rents or sales prices.** Many market rate developers expressed that City policy is shifting toward providing fewer parking spaces than the market is demanding, while some affordable housing developers felt that the City demands too much parking for their projects. City code currently requires 1 space per market rate unit and 0.5 spaces per affordable unit within the Central Petaluma Specific Plan Area. Outside of this area, City code requires 1 parking space per bedroom, and at least 1.5 spaces per unit. An examination of the current housing project pipeline indicates that most affordable projects are providing between 0.75 and 1 space per unit, higher-density (30 units/acre+) market rate developments are providing approximately 1.5 spaces per unit, and lower-density market-rate units are providing between 1.5 and 2.25 spaces per unit. It is not clear, however, whether these estimates are the result of market preferences, or the complex negotiations between the City and developers for each project.

**Petaluma's ground-floor retail requirements create operational and cost challenges for developers of affordable and market rate housing, suggesting a need to carefully target these requirements in the most critical locations.** Local developers expressed that the City's ground-floor retail requirements do not always align with areas of strong demand for retail uses, such as along segments of Petaluma Boulevard North. It can be difficult for developers to successfully tenant these spaces, and affordable housing developers noted that operating a retail component creates administrative challenges for a housing-focused nonprofit. Vacant or underutilized retail spaces create a dual negative impact on projects by increasing construction costs and reducing revenues.

**The Urban Growth Boundary was not a primary concern of developers but does contribute to overall land constraints for housing development.** The Urban Growth Boundary limits the outward expansion of the city and thus impacts the types of housing products required to meet the City's housing goals. For example, as a result of the Urban Growth Boundary and the limitations it imposes on available land, an Urban Land Institute Technical Assistance Panel recommended that Petaluma emphasize infill development and pursue higher density development in order to achieve housing production goals.<sup>20</sup>

**Local developers and ADU specialists noted that few local regulatory barriers exist to ADU production but cautioned that any future affordability requirements for ADUs could constrain production.** In Petaluma, ADUs are often affordable to moderate income households due to their small size. Of the 106 ADU units permitted in Petaluma between 2018 and 2021, 104 were considered moderate-income, while two were considered above moderate-income, and none were considered low-income or below.<sup>21</sup> None of the ADUs that were produced were deed-restricted units.

<sup>20</sup> ULI San Francisco. (2020). City of Petaluma Technical Assistance Panel Report.

<sup>21</sup> California Department of Housing and Community Development, Annual Progress Report, 2022.



**Petaluma’s inclusionary housing requirements are an important tool for producing affordable housing units, although most multifamily development is currently infeasible in Petaluma and unlikely to produce significant units or revenues in the short term.** Inclusionary housing requirements can only contribute to affordable housing production when market rate housing projects are financially feasible for a developer to build. Inclusionary requirements themselves reduce the feasibility of new development by reducing achievable revenues or increasing costs for in-lieu fees or other mitigations. Therefore, regular re-study of requirements is necessary to ensure they are set at a level that ensures market rate projects remain feasible while still supporting affordable housing. A separate analysis completed by Strategic Economics found that new multifamily development projects are not likely to currently achieve financial feasibility in Petaluma—although inclusionary requirements are not the sole cause of this infeasibility. Instead, construction costs are significantly higher than local rents and sales prices for the studied housing products.

**Readily allowing flexible alternative mitigations to the inclusionary requirements—including land dedications—can help to support production of additional affordable housing units and/or deeper affordability levels of those units.** Affordable and market rate housing developers interviewed for this study stated a preference for inclusionary projects that utilize separate parcels within larger development projects, when possible. Affordable housing developers can pursue more sources of subsidy when they have full control over a project site, and therefore develop more units for the same cost.

**Inclusionary housing in-lieu fee contributions can also provide a flexible local funding source for affordable housing, but total revenue is likely to be limited.** The City of Petaluma can provide discretionary authorization for payment of in-lieu fees rather than provision of on-site inclusionary units. Since only a few projects generate in-lieu fee revenue each year, the City may not collect sufficient funds to adequately support affordable housing developments through this source alone. However, in-lieu fees serve a valuable role in providing local funds for 100 percent affordable housing projects and administering City housing programs.

**The City’s development impact fees were noted by both affordable and market rate developers as higher than those in neighboring jurisdictions,<sup>22</sup> but the City recently took steps to reduce impact fees for affordable developments.** The Petaluma City Council’s November 2022 resolution eliminated facilities, parkland, traffic, and open space impact fees for deed-restricted affordable housing projects. Affordable housing projects are still required to pay impact fees for water and wastewater capacity, and all impact fees are still applicable to market rate housing projects. If high costs of impact fees induce market rate developers to build elsewhere or construct fewer units, this could limit the City’s ability to leverage new market rate production to produce new inclusionary units or revenue.

**Petaluma’s current impact fee structure incentivizes development of fewer units with larger sizes because it is expressed on per unit basis rather than per square foot basis.** This policy could result in the production of fewer inclusionary units, since inclusionary requirements are calculated based on the total units in a project.

**Further impact fee waivers and reductions would create a significant additional financial incentive for production of ADUs.** ADU developers and specialists interviewed for this study noted that impact fees create a relatively high cost burden for ADU projects as a share of overall development costs. The City of Petaluma does reduce impact fees for ADU developments in comparison to single or multi-family

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<sup>22</sup> ULI San Francisco. (2020). City of Petaluma Technical Assistance Panel Report.

units and has eliminated them for ADUs of less than 750 square feet. However, fees for larger projects can be around \$9,000 out of a total construction cost between \$175,000 and \$450,000.

## Processing and Approvals Impacts on Production of Affordable Housing

Strategic Economics gathered feedback from local affordable housing and market rate housing developers to identify common concerns regarding potential areas of improvement for the City's development review and approval process. Delays and uncertainties associated with these concerns can ultimately impact the ability to produce affordable housing by slowing production of units (whether in 100% affordable projects or market rate housing projects). These slowdowns can go beyond delays in building an individual project by increasing total development costs, causing projects to not move forward due to missing strong market cycles, and discouraging future development activity. As demonstrated by Petaluma's 2023 Community Development Department Strategic Plan, the City is working to resolve this challenge.

**Opportunities exist to improve coordination and communication between departments while conducting project reviews.** Developers noted that different departments are not always in agreement about what is expected or what has been approved, and that communication between reviewers is not always effective. Some of these issues are likely to be resolved with the formation of a joint Community Development Department in recent years, but the development review process will still require coordination with other departments, such as Fire and Public Works. This can lead to cases in which a project advances quickly through several stages of review, only to be held up for an extended period of time with one department. A lack of recorded agreements and approvals can also be a challenge, causing delays when staff turnover occurs.

**SB 35 provides opportunities to circumvent CEQA and streamline processing of applications, but also mandates the use of prevailing wages—which substantially increase costs for developers.** Affordable housing developers expressed that using prevailing wages would increase their labor costs by approximately 30 percent to 35 percent—a cost that in many cases would counteract any benefits that could be gained by utilizing a streamlined approval process. In the face of these challenges, there may be opportunities for Petaluma to establish its own standards for expedited processing that do not require developers to pursue SB 35 processes.

**Developers raised concerns regarding uniquely unclear development expectations and discretionary approvals processes in Petaluma.** Developers interviewed for this study noted that Petaluma poses unique challenges in navigating the community and decisionmakers' expectations as part of discretionary approvals. The uncertainties and extensive process involved in understanding and achieving an acceptable yet feasible project design add significant time and costs for many projects. The Site Plan and Architectural Review (SPAR) process was raised by multiple interviewees as an especially significant source of uncertainty and delay.

**Development review and approvals processes are especially confusing and unclear for homeowners pursuing ADU projects.** Issues raised by interviewees included difficulty navigating the permitting portal itself and being able to easily understand all the approvals, fees, and inspections required to build an ADU.

# Recommendations for Supporting Affordable Housing Production in Petaluma

The following policy recommendations address the major affordable housing production challenges identified in this report. The recommendations correspond to closing the funding gap for affordable housing projects, reducing development costs, increasing application processing speed and certainty, and providing additional supports for ADUs as a source of “naturally occurring” non-deed restricted affordable housing.

The first set of recommendations pertains to developing financial resources to support affordable housing. Affordable housing developments in Petaluma and Sonoma County currently receive lower shares of funding from local sources than developments elsewhere in the Bay Area. The City can help close the local funding gap by supporting new funding resources or optimizing the use of existing policies so that they leverage private or external funding sources.

- **Support expanded approaches to increase City funding that can be allocated to affordable housing development.** Examples of potential City-level approaches for expanding affordable housing funding could include re-allocation of General Fund expenditures, dedication of property tax transfer revenues to affordable housing, passage of a local housing funding measure, and the creation of a City-owned land bank.
- **Support county or regionwide approaches to increase outside funding that can be allocated to affordable housing development, such as county-level affordable housing bond measures or support for the Bay Area Housing Finance Authority (BAHFA).** A county-wide bond measure similar to Alameda County’s Measure A-1 could provide significant funds for affordable housing projects. Similarly, BAHFA is an emerging initiative to support regional housing coordination and provide funding for affordable housing development; Petaluma’s participation in this initiative could result in greater funding opportunities and region-wide solutions to affordable housing needs.
- **Clarify expectations regarding the circumstances under which alternative mitigations to inclusionary housing requirements are allowed, with particular emphasis on allowing 100 percent affordable housing project development via land dedication and other contributions.** By providing further clarity on alternative mitigations, the City can ensure that tradeoffs facing market-rate developers are optimized to produce affordable units through multiple approaches:
  - Codifying policies for off-site or separate-parcel development of inclusionary housing units can enable market-rate developers to consistently partner with affordable housing developers, who can leverage additional funding resources and provide deeper levels of affordability for required units.
  - Alternatively, on-site inclusionary units have the potential to provide affordability without public subsidy, but are currently considered less attractive to developers than off-site units or payment of an in-lieu fee. The City may want to evaluate raising in-lieu fee rates to make this a more viable source of affordable housing funding for developers of 100 percent affordable projects while also potentially creating an incentive for market rate developers to provide on-site affordable housing units within their projects.

- **Target and support affordable housing development opportunities in areas that are more competitive for state funding, such as High Resource areas and places in close proximity to assets like libraries, parks, and the existing and proposed SMART stations.** Petaluma has very little overlap between places designated as High Resource Areas and places with other amenities that score highly on affordable housing finance applications. The City may be able to increase chances for developers to attract external affordable housing funding by prioritizing new affordable housing projects in areas that are best aligned with state funding priorities.

The City of Petaluma also has the ability to influence overall costs of affordable housing production through its policies for development requirements, fees, and incentives. These policy changes can help decrease overall funding gaps that must be filled with external funding sources for 100 percent affordable projects. For market rate projects, these policies can help increase the total number of projects that are feasible—thereby increasing overall inclusionary housing unit production.

- **Through the General Plan process, revisit and modify the locations in which ground floor retail is required as part of housing development projects, or exempt affordable housing projects from this requirement.** Affordable housing developers indicated that filling retail vacancies can add extra time and costs to an already challenging development process. In addition, developers indicated that the viability of retail on a particular site depends on a variety of factors, such as the site's accessibility, target tenants, and location. Allowing affordable developers flexibility on requirements such as retail or parking ratios can allow them to tailor their proposals to the conditions of their site, and lead to more successful projects overall.
- **Study potential unintended impacts of the current impact fee structure for market rate units and whether it should be based on square footage of developments instead of the total number of housing units for multifamily development projects and ADUs.** The current impact fee structure incentivizes the construction of larger housing units but fewer overall units, because impact fees are based on the total number of housing units in a project. Assessing fees based on the net dwelling area of the project could result in production of more, but smaller units. Since inclusionary requirements are assessed on a per-unit basis, this could result in additional production of inclusionary units.
- **Consider impact fee reductions or waivers in exchange for greater affordable housing production in market rate projects.** The City's fee waiver for 100 percent affordable housing projects will support the construction of units in those projects but did not apply to affordable inclusionary units in market rate projects. Additional fee waivers could be structured as an incentive for market-rate developments that offer affordable units in excess of current inclusionary requirements.

Increasing certainty and timeliness of affordable housing approvals can also result in increased affordable housing production, by giving developers confidence that their projects will be successfully approved in a timely manner. These measures could also result in additional inclusionary housing production, if market-rate developers are more willing to propose new projects in Petaluma as a result of reduced investment risk and reduced holding costs prior to project construction.

- **As begun with the Corona Road SMART Station PDA Specific Plan effort, create more area plans which can be used to increase development certainty for prospective developments.** Specific plans can reduce environmental review timelines and risks for new developments by including a Program Environmental Impact Report (EIR). These plans can also give developers confidence to propose new projects by increasing clarity about the standards that need to be met

to obtain approval. Such plans could help to accelerate proposals for and development of affordable housing projects or market-rate projects with inclusionary units.

- **Complete and implement the City’s current efforts to create objective standards for design review and development approvals.** Developers highlighted Petaluma’s SPAR process as uniquely unclear and discretionary, creating challenges for developers in understanding the acceptability of their proposed projects. The City is currently working on updating its design standards, which can help developers prepare project proposals that achieve design quality while reducing hurdles and delays for approval.
- **Identify internal process improvements to improve the efficiency and transparency of project application processing**—as identified in the Community Development Department Strategic Plan. Developers of affordable, market-rate, and ADU projects indicated a lack of clarity in use of Petaluma’s permit application portal, and expressed that they experienced challenges progressing linearly through the project approval process. Improved interdepartmental communication and clearer documentation of attained milestones could speed up processing times and allow Petaluma to produce more affordable units.
- **In addition to the two staff positions being added by the Housing Department in 2023, continue analyzing potential opportunities to increase City staffing resources.** Stakeholders expressed that the City is short-staffed, indicating that while individual staff members have been great to work with, the City needs to dedicate additional funding resources to carry out planning processes. The City could potentially undertake a staffing and service costs study to determine the adequacy of existing cost recovery fees and examine potential new funding opportunities.

Petaluma can also enact new policies and increase funding to support ADUs as a non-deed restricted “naturally occurring” affordable housing option. Encouraging homeowners to invest in ADUs is one option for Petaluma to meet affordable housing goals—particularly for moderate income units—with little or no external subsidy.

- **Continue increasing financing and education opportunities for homeowners who are interested in constructing ADUs.** The City already waives development impact fees for ADUs that are less than 750 square feet, but the City could consider increasing the size threshold under which ADUs are allowed fee exemptions. The City has also entered into a partnership with a regional ADU support organization, Napa Sonoma ADU Center, as of January 1, 2023. Additional opportunities for funding or educational support could include predevelopment grants or financial incentives for homeowners who pursue ADU projects. ADUs that are larger than 750 square feet could also benefit from evaluation of impact fees on a per square foot instead of per-unit basis, which would provide some relief for these smaller units.
- **Continue refining tools to make development of ADUs simpler and clearer.** Homeowners typically have less experience than professional developers in navigating the permitting and approval process. The City can clarify development processes for ADUs to ease the learning curve for homeowners who are considering new projects. In addition, the City could simplify the design process for homeowners by pre-approving a set of ADU plans for use within Petaluma. Some of this has already begun with Petaluma’s partnership with Napa Sonoma ADU Center, which provides plans and guidance for ADU development.