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November 8, 2023

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BY ELECTRONIC MAIL

Mayor Margaux Keiser (margauxkeiser@gmail.com) Vice Mayor Kristen Brown (thekristenbrown@gmail.com) Councilmember Yvette Brooks (ybrooks@ci.capitola.ca.us) Councilmember Joe Clarke (JClarke@ci.capitola.ca.us) Councilmember Alexander Pedersen (apedersen@ci.capitola.ca.us)

#### Re: Merlone Geier Partners' Additional Comments on 2023 - 2031 Draft Capitola Housing Element Update

Dear Mayor Keiser, Vice Mayor Brown, and Councilmembers Brooks Clarke and Pederson:

Our firm represents Merlone Geier Partners ("MGP"), the owner of the majority of the Capitola Mall site (the "Mall") and more specifically Assessor's Parcel Numbers 034-261-15; -37;- 38; - 39; and -40 (the "Property"), which are collectively targeted for 679 residential units under the City's November 3<sup>rd</sup> draft Housing Element for the 2023-2031 planning cycle ("Draft Housing Element"). These 679 units represent more than fifty percent of the City's entire Regional Housing Needs Assessment ("RHNA") allocation. Accordingly, we believe it is necessary for the City of Capitola ("City") to give due consideration to MGP's concerns regarding the viability of the City's strategy for delivering these units. Staff still has not addressed the comments detailed in our letter of August 1, 2023, which is attached here as <u>Exhibit A</u>. As further explained below, the Draft Housing Element is further revised to require specific zoning modifications, the Property will continue to be used solely for commercial use throughout the 2023-2031 planning cycle.

# There is No Evidence in the Draft Housing Element to Support the Assumption that the Property Can be Developed at a Density of 29 Units Per Acre Under Current Development Controls

Both our August 1, 2023 comment letter and comments from the Department of Housing and Community Development's ("HCD") dated October 1, 2023 advised the City that the Draft Housing Element must evaluate *realistic* development capacity for nonvacant sites included in the housing sites inventory. Refer to our August 1, 2023, letter for a summary of the Government Code requirements and to HCD's technical advisory publication describing the acceptable methodologies for performing this analysis.

The Draft Housing Element relies on MGP's 2019 site redevelopment application and "conversations" with MGP to substantiate its assumption that the Property can support a density of approximately 29 units per acre. This assumption yields a total of 679 units on the 23.42

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acres of land included within the Property. Instead of evaluating whether site development controls, including maximum building heights (whether those heights are 40' or 50' with the possible *discretionary* height increase under City Code Section 17.88) or maximum floor area ratio (FAR) (whether at an FAR of 1.5:1 or the possible *discretionary* FAR of 2:1), the Draft Housing Element merely states that because MGP's 2019 application requested discretionary approvals for a project at a density of 20 units per acre and MGP has previously expressed an interest in developing the Property at 30 units per acre, that the Property thus supports the density projected in the housing sites inventory analysis (i.e., nearly 29 units per acre).

There is a glaring oversight in the City's density assumption. As shown in <u>Exhibit B</u> attached hereto, MGP's 2019 application assumed that building heights would be increased to 75' to achieve a density of even 20 units per acre. This application was ultimately withdrawn, meaning that the City did not increase the height limit beyond 40' or 50' (assuming approval of the discretionary 10' height incentive under City Code Section 17.88). Thus, the Draft Housing Element assumes a height increase that has not been adopted as a zoning amendment or directed as a future zoning amendment as a policy in the Draft Housing Element. The 2019 MGP application is therefore not representative of the Property's realistic development capacity per the requirements of Government Code Section 65533.2. Likewise, "conversations" between MGP and the City about possible redevelopment at 30 units per acre, without any accompanying actions by the City to modify the Property's zoning to achieve that number, are not adequate to satisfy the requirements of Government Code Section 65533.2.

# Delaying Identification – Let Alone Implementation – of Necessary Zoning Changes until 2027 Will Not Deliver Housing Within the 2023-2031 Planning Cycle

The Draft Housing Element does not include any policy changes designed to actually deliver housing on the Property within the 2023-2031 planning cycle. While the City could, as MGP suggested, include policies directing an increase in maximum building height and FAR or establish a minimum density consistent with projections in the Draft Housing Element, the draft instead defers any analysis to a future study that will "identify[] strategies to initiate mall redevelopment" to be overseen by a "technical committee." (p. 5-10.) And then, "if by 2027, [it] becomes apparent that redevelopment of the Mall site is not achievable, the City will develop alternative strategies to the 6th Cycle RHNA requirement." (*Ibid*.)

There is no reason to defer identification of strategies to initiate redevelopment of the Property consistent with the Draft Housing Element's proposed densities. The very application that the City relies on to support its density assumptions (MGP's 2019 application) demonstrates that a height increase to 75' – coupled with other modifications to current development controls -- are necessary to achieve even a lower density than the 29-units per acre projected in the Draft Housing Element. The City can – as other jurisdictions have done across the State – adopt a minimum development density that corresponds with the assumptions in the Draft Housing Element. The City's proposed deferral of these decisions to a committee provides no assurance that the City will take the zoning actions necessary to enable over 50% of the City's RHNA allocation.

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Moreover, waiting until 2027 to see if the committee's unspecified strategies work and, if not, to then "develop alternative strategies" is not a strategy. To implement zoning changes in 2027, the City would need to evaluate those changes under the California Environmental Quality Act (Pub. Resources Code, § 21000 et seq., "CEQA"), presumably by preparing and then certifying an environmental impact report. Zoning modifications would need to be approved by ordinance and would be subject to referendum. Even assuming the City were to successfully navigate the legal process to adopt the zoning changes, there would be very little time left within the 2023-2031 planning cycle to build *any* of the units, let alone the several buildings that would contain all 679 units presumed in the Draft Housing Element.

MGP continues to insist that the Draft Housing Element should include the following if the City is to rely on redevelopment of the Property for at least 679 units during the 2023 – 2031 planning cycle:

- Increase maximum building heights to 75' (excluding mechanical features) independent of any kind of discretionary incentive concept as in City Code Section 17.88.
- Increase maximum FAR from 1.5:1 to 2:1 and exclude any structured parking from the calculation. Here too, the increase in FAR should not be dependent on the award of any discretionary incentives as in City Code Section 17.88.
- Establish a minimum density of 29 units per acre.

# The Property Will Only be Redeveloped During the Planning Cycle if MGP Is Willing to Participate in that Process

As HCD noted, the Property is nonvacant and already occupied by ongoing commercial users. MGP can continue operating the site as a commercial project, including by extending current leases or signing new leases over time. Conversion of some or all of the Property to residential use requires a substantial investment of capital that would need to be justified by the project's economics. MGP is a leading developer, owner, and operator of mixed-use projects all over the West Coast. MGP – and not a technical committee or any group of consultants that the City might enlist – best understands what is required for an owner to pursue the redevelopment contemplated by the Draft Housing Element.

The zoning changes identified above are essential to any potential redevelopment during the 2023-2031 planning cycle, as those changes would eliminate significant entitlement, development and schedule risk that MGP will not otherwise be willing to assume. That said, if the City were to adopt these minimum changes and certify a corresponding environmental analysis, MGP would evaluate scenarios pursuant to which it would deliver *more* than 679 units to make even greater progress toward the City's RHNA allocation. Again, MGP's willingness to take on this work will depend on the City's implementation of these specific, objective changes to zoning constraints in the near term, rather than deferring possible changes to future studies or analyses by a committee.

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MGP remains willing to collaborate with the City in its efforts to achieve certification of its 2023-2031 Housing Element. However, we do not believe the Draft Housing Element can or should be certified in its current form for the reasons detailed above. We encourage the City Council to delay action on the Draft Housing Element to incorporate the modifications requested above and to bring the draft back for adoption and subsequent certification by HCD at a later date.

Regards,

Wart Gray

Matthew S. Gray

MSG:gjc

cc: Jamie Goldstein, City Manager Eric Phillips, Burke, Williams & Sorensen LLP Paul McDougall, HCD

### <u>Exhibit A</u>

August 1, 2023, Letter



505 Howard Street Suite 1000 San Francisco, CA 94105-3204



August 1, 2023

Matthew S. Gray MGray@perkinscoie.com D. +1.415.344.7082

Jamie Goldstein City Manager City of Capitola Capitola City Hall 420 Capitola Ave Capitola, CA 95010

### Re: Capitola Housing Element 2023-2031 (May 2023 Draft)

Dear Mr. Goldstein,

Our firm represents Merlone Geier Partners ("MGP") the owner of Assessor Parcel Numbers 034-261-07; -15; -37; - 38; -39; and -40 (collectively, the "Property") which comprise approximately 31 acres of the Capitola Mall, and which the City of Capitola ("City") is relying on to accommodate nearly 64 percent of its Sixth Cycle Regional Housing Needs Allocation ("RHNA") obligation of 1,336 units. The purpose of this letter is to express MGP's concerns regarding the May 2023 draft 2023 – 2031 Housing Element ("Draft Housing Element"). In summary, the Draft Housing Element fails to comply with State law, and it must be revised to include policies to address development constraints would undoubtedly prevent development of 853 during the planning cycle as contemplated in the draft.

We note at the outset that MGP has extensive experience as an owner and operator of similarly situated properties all along the West Coast. MGP has successfully redeveloped more than a dozen mall properties for alternative uses, including multi-family residential, and is currently pursuing the redevelopment of several other such projects in Northern California (including in Alameda County, Santa Clara County, and Marin County). Based on this experience, MGP offers the following comments with the goal of informing the Draft Housing Element both so that it conforms with State law and so it can be used to achieve the stated purpose of facilitating actual housing development in Capitola.

# The Draft Housing Element Fails to Account for Development Constraints as Required by the Government Code

The Government Code establishes requirements for the evaluation of nonvacant sites included within a housing element, including for purposes of determining realistic development potential. Additional guidance is provided by the California Department of Housing and Community Development ("HCD"), which is summarized in HCD's Housing Element Site Inventory Guidebook – Government Code Section 65533.2 dated May 2020 ("HCD Guidebook"). As stated by HCD, "a local government [must] calculate the projected residential development capacity of the sites in the housing element that can be realistically achieved" and this must be done using one of two approved methodologies. (HCD Guidebook, p. 19.) First, the agency

may use minimum densities, but only if it has adopted a "local law or regulations that require the development of a site at a minimum density." (Govt. Code, § 65583.2(c)(1).) Second, where the agency has not established a minimum density, the agency can use "factors" to derive realistic development capacity. Under this scenario, the agency "must describe the methodology used to determine the number of units calculated" based on, among other things, the land use controls that govern the property. (Govt. Code, § 65583.2(c)(2).)

The HCD Guidebook states as follows:

The analysis must consider the imposition of any development standards that impact the residential development capacity of the sites identified in the inventory. When establishing realistic unit capacity calculations, *the jurisdiction must consider the cumulative impact of standards such as maximum lot coverage, height, open space, [and] parking* . . . The analysis should consider any development standards or the cumulative effect of development standards that would limit the achievable density on a site. For example, if a mixed-use zone requires commercial on the ground floor and has a height limit of three stories along with lot coverage and other development standards, the density that actually can be achieved on the site might be less than the maximum allowable density.

(HCD Guidebook, p. 20; emphasis added.)

The Draft Housing Element lists the Property as part of the Sites Inventory in Appendix D. Each of the parcels is identified as "nonvacant" and the City projects a *minimum* of 853 units on the site in the aggregate during the 2023-2031 planning period. (Draft Housing Element, p. 4-28.) These units are anticipated to be built under the Property's current regional commercial (C-R) zoning without any zoning amendments. (*Ibid.*) The calculation of 853 units is derived solely from purported "conversations" between MGP and City staff in which "an overall minimum residential density of 29 dwelling units/acre" was discussed. The City then multiplies this conjectural 29-units per acre number by the 29.4 acres that the City believes comprise the Property, to establish a minimum development capacity of 853 units.

The City's calculation of the Property's development capacity fails to satisfy the requirements of Government Code Section 65583.2(c). As the City notes in the Draft Housing Element, the Property is not subject to any regulation that establishes a minimum residential density. Therefore, realistic development capacity must be evaluated under Government Code Section 65583(c)(2), which requires an evaluation of applicable land use controls. Further, per Section 65583(c)(1), the City must "demonstrate how the number of units for the site . . . will be accommodated." The Draft Housing Element does not include an evaluation of how General Plan, C-R zoning, or other Municipal Code provisions limit development on the Property. There is no evaluation of applicable height, floor area ratio, setback, ground-floor commercial use requirements or other limitations that affect the delivery of housing. The City's assumption that the Property can accommodate 29 units per acre or a minimum of 853 units under applicable

development controls is not based on substantial evidence that satisfies Government Code requirements.

# The Property's Zoning Must be Modified to Accommodate a Minimum of 853 Units on the Developable Portions of the Site.

MGP evaluated the site to determine whether a minimum of 853 residential units can be developed as part of a mixed-use project during the 2023-2031 Housing Element cycle. Consistent with State law for nonvacant commercial sites, MGP quantified the portion of the Property that can be redeveloped during the planning cycle. This analysis reflects the following:

- <u>Property subject to long-term leases</u>: Certain MGP-owned property, including existing buildings and portions of the MGP-owned surface parking area, are subject to leases in favor of commercial tenants that extend through the 2023-2031 planning cycle. Of the 1,369,690 square feet of the Property that MGP owns, 442,771 square feet including the Kohl's building, portions of the existing central mall, and parking fields servicing Target and Macy's are subject to leases and therefore must be excluded, bringing the developable area down to 926,919 square feet. The areas encumbered by leases and which are ineligible for redevelopment are shown on <u>Exhibit 1</u> attached hereto, including the cross-hatched areas shown as areas "A" through "D" on the Exhibit.
- Retained retail: As MGP understands from its experience on similar projects, successful mixed-use retail and residential projects require a critical mass of retail to achieve a sense of a place. Preservation of a certain amount of the existing retail structures is also necessary from an economic perspective due to land economics and to sustain a portion of existing sales tax revenues flowing to the City. Further, the General Plan and the 41<sup>st</sup> Avenue / Capitola Mall Re-Visioning Plan call for preservation of retail as part of any redevelopment. As such, we assume that fifty percent of the existing MGP-owned retail building area (excluding Kohl's which is already excluded due to the lease constraint) will be retained for retail. This amounts to 149,660 square feet. Parking spaces must also be preserved to service the retained retail space. We assume an industry-standard four spaces per 1,000 square feet of retail will be required to attract tenants. Accordingly, we assume 300,000 square feet of surface area would be set aside to build 600 parking spaces of 500 square feet each.

In light of the above site constraints <u>477,259 square feet</u> of MGP-owned portions of the Property is subject to redevelopment during the 2023-2031 Housing Element cycle. This requires a minimum density of approximately 80 units per acre to achieve a minimum of 853 residential units during the planning period.

Modifications to the Property's zoning are required if the City intends to make a good faith effort to comply with State law requirements. Specifically, the following changes to the C-R zoning controls are necessary to achieve a minimum density of 80 units per acre on the 477,529 square feet of land eligible for redevelopment and facilitate at least 853 residential units during the Housing Element cycle:

- Maximum building height should be increased from 40 feet to 75 feet, not counting building mechanical features.
- Maximum FAR should be increased from 1.5:1 to 2:1 and should exclude any structured parking from the calculation.
- the prohibition on ground-floor residential use should be eliminated. The prohibition of ground-floor residential provides a further site constraint and obstacle to achieving the desired minimum number of residential units.

#### Development "Incentives" under Municipal Code Section 17.88 Do Not Constitute Development Controls for Purposes of Calculating Realistic Minimum Development Capacity

Section 17.88 of the Municipal Code authorizes the City Council to grant "incentives" that could partially alleviate the zoning constraints outlined above, namely by marginally increasing maximum height and FAR. These potential incentives should not be misconstrued as if they represent prevailing site controls that permit the minimum development capacity of the Property.

First, an applicant is not entitled to the incentives even if the applicant agrees to provide one of the "benefits" listed in Section 17.88.040(A)(1) - (11). The operative language states: "the public benefit provided shall be of sufficient value as determined by the planning commission to justify deviation from the standards of the zoning district that currently applies to the property." As such, the Planning Commission must make a subjective determination that the "value" of the benefit is sufficient, which determination is then provided to the City Council in the form of a recommendation. There is no methodology prescribed in the Code for how the Planning Commission determines that the value of an offered public benefit is sufficient to justify an incentive as applied to a given project. Similarly, the City Council must find that the proposal provides a "substantial benefit" to the community. This is a subjective determination, particularly given that the Code contains a list of eligible project benefits under Section 17.88(A).

Second, to obtain an incentive, the applicant must agree to provide public benefits in excess of the types of development exactions that the City could otherwise require by law as a condition of development approval. Section 17.88.020 states that the City may grant incentives only when the "community benefits offered are not otherwise required by the zoning code or any other provision of local, state, or federal law." Similarly, the Council must find that the offered public benefit "exceeds the minimum requirements of the zoning code or any other provision of state or federal law." The City cannot lawfully require an applicant to provide the public benefits under Section 17.88.040 to obtain the incentives under Section 17.88.050 as a condition of a development approval in another form, e.g., a variance or condition of use permit, since requiring a public benefit with no relationship to the proposed incentive (as opposed to, e.g., requiring setbacks to offset aesthetic or shadow impacts associated with a building height increase) would constitute an unconstitutional condition. (See *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987) (there must be a nexus between a permit condition imposed on the specific regulatory interest advanced by the condition); *Dolan v. City of Tigard*, 512 U.S.

374 (1994) (requiring proportionality between the condition imposed and the impact to be addressed by the condition); *California Building Association v. City of San Jose* 61 Cal.4th 435, 492 (government may not impose a condition on the receipt of a benefit that requires the individual to give up a constitutional right, including the right to demand compensation for a taking of his or her property).) It cannot be assumed that MGP will agree to provide such benefits as a condition of obtaining only partial relief from the zoning standards that will otherwise prevent the development of the minimum 853 units.

### Assuming that MGP Chooses to Negotiate a Development Agreement, the Development Agreement Cannot Substitute for Addressing Development Constraints in the Draft Housing Element

The Draft Housing Element incorrectly assumes that any development constraints applicable to the Property will be addressed through a development agreement rather than through zoning amendments. Specifically, the draft states:

The City intends to establish a Development Agreement (DA) that would serve as an added layer to the existing Regional Commercial (C-R) zone that would set forth specific development regulations for the mall site project area to guide future development of residential uses while providing for the redevelopment of retail and commercial uses.

#### (Draft Housing Element, p. 4-28.)

This is flawed for two reasons. First, the City cannot unilaterally "establish" a development agreement governing the Property. MGP, in its discretion, would choose to apply for a development agreement and the parties would then negotiate the terms at arm's length each in their sole discretion. (See Govt. Code, §§ 65864 *et seq.*; see also Municipal Code Chapter 18.04.030(E) ("A development agreement is a contract that is negotiated and voluntarily entered into by city and applicant and may contain any additional or modified conditions, terms or provisions agreed upon by the parties".) The development agreement would then need to be approved at the City Council's discretion at the conclusion of the project approval process. (Municipal Code, § 18.04.040(F).) Second, a development agreement is not a mechanism for amending the site development controls that pertain to a particular property. Rather, the development agreement vests the applicant's rights to complete the project in accordance with "the rules, regulations, and official policies in force at the time of execution of the agreement." (Govt. Code, § 65866(a).) Therefore, without a prior or concurrent modification of the site controls, any development agreement would only vest MGP's right to develop the Property in accordance with the C-R zoning constraints described above.

The Draft Housing Element should be amended to incorporate procedures for modifying C-R zoning provisions rather than assuming that a future development agreement will serve that purpose. As outlined above, MGP cannot be compelled to enter into a development agreement. The City should not assume that delaying State-mandated zoning changes in the Housing Element will bring MGP to the table for future development agreement negotiations. This

approach does not satisfy Government Code Section 65583(c)(1)'s mandate for the City to demonstrate how it will accommodate its RHNA obligation, particularly given that the development agreement would not on its own address the current site development constraints.

### Proposed Affordable Housing Projections for the Property Are Not Realistic

Appendix D of the Draft Housing Element indicates that of the 853 units allocated to the Property, 65 percent of those units would be reserved for low or moderate-income households. While we understand that the City is challenged to find suitable locations to accommodate affordable units within its jurisdiction, it is not realistic to assume that the Property (or any property for that matter) can be redeveloped with only 299 out of 853 units (35 percent) not being subject to income-based restrictions. The Property is currently developed with viable commercial uses, and even for the former Sears building, the site can be repositioned as needed to attract other commercial users. It would be economically infeasible to terminate the current regional commercial land uses and instead devote the Property to a predominantly affordable housing project.

In addition, saddling MGP-owned properties with such a disproportionately high amount of the City's share of below-market-rate development obligations violates the City's legal obligations to treat similarly situated properties equally. Moreover, the infeasibility of providing such a disproportionately high amount of affordable housing within any market rate development proposal, coupled with the City's obligations under the No Net Loss Law to not approve projects providing less than the proscribed amount of affordable housing (unless the affordable units are replanned for another site), would result in an unconstitutional taking of MGP's property without just compensation. The Draft Housing Element should therefore be revised to reflect more reasonable assumptions for affordable housing at the Property.

We look forward to reviewing the next draft of the housing element and remain willing to engage with the City throughout the update process.

Ward Sour

Matthew S. Gray

MSG:gjc

### Exhibit 1

(attached)





### <u>Exhibit B</u>

MGP's 2019 Application Site Plan







BUILDING B Elevations

Merlone Geier Capitola Mall







BUILDING B Elevations

Merlone Geier Capitola Mall Partners Capitola, California





Elevation B-3A





BUILDING A Elevations

Merlone Geier Capitola Mall



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Elevation A-1A

