



Community & Economic Development Department

Memo

To: Planning Commission

From: Katie Herlihy, Community and Economic Development Director

Date: February 3, 2026

Subject: Item 6A – Capitola Mall Zoning Code Amendments for Housing Element Implementation. State of California Housing and Community Development (HCD) response to Enforcement Division Letter.

This memorandum is intended to provide background and context regarding additional materials received from the California Department of Housing and Community Development (HCD) on January 30, 2026, after publication of the Planning Commission agenda for Item 6A, Capitola Mall Zoning Code Amendments for Housing Element Implementation.

On January 13, 2025, HCD contacted Director Herlihy to inform the City that an enforcement complaint had been filed to the state related to the proposed Capitola Mall Zoning Code Amendments and requested a meeting to discuss. In response, Director Herlihy scheduled a meeting with HCD and requested additional information.

City staff met with HCD on January 27, 2026, to discuss the contents of the complaint letter and HCD's preliminary concerns. Following that meeting, on January 28, 2026, Director Herlihy sent a follow-up email to HCD outlining how staff intended to address the issues HCD raised in response to the complaint through revisions and clarifications to the draft Capitola Mall Zoning Code Amendments. City staff incorporated these revisions into the amendments which were published on January 30, 2026, for the February 5, 2025, meeting packet.

On January 30, 2026, City staff received a written response from HCD, in response to Director Herlihy's January 28, 2025 email, providing three specific suggested modifications to the draft Capitola Mall Zoning Code Amendments. Director Herlihy's email and HCD's response are included as Exhibit 1. HCD's written response to Director Herlihy's January 28, 2025, email outlined three (3) issues of concern from HCD, including:

1. Section 17.24.035.E Land Use Regulations. Clarifying parameters for a Conditional Use Permit (CUP) submittals for residential development.
2. Section 17.57.040(B)(2). Deviations to Objective Standards. Redundancy between deviations and state density bonus law.

3. Section 17.24.035(E)(2)(c) Fiscal Impact Analysis. Update to exempt 100 percent residential projects and ensure FIA cannot be used to justify a reduction in the residential units/residential floor area in a proposed project.

Staff is proposing further modifications to the January 30 draft in response to HCD's January 30th written communication for Items 1 and 3 identified above. Staff's position is that the January 30 draft's proposed edits are already fully responsive to the HCD's concerns with respect to Item 2. The January 30 draft with the further proposed edits are included on the next two pages, with the updated text **highlighted**.

Item 1. 17.24.035.E

E. Land Use Regulations. All land use regulations and permit requirements in Section 17.24.020 (Land Use Regulations) apply to development with new residential uses on the Capitola Mall property a Housing Element Site, except as follows:

1. Within a Tier 2 or Tier 3 mixed-use project, including a change of use within an existing Tier 2 or Tier 3 mixed-use project, the following land uses are permitted “P” uses ~~provided that they do not exceed 50 percent of the total floor area of the project:~~

- a. All hotels.
- b. All retail uses.
- c. Eating and drinking establishments, excluding bars and lounges.
- d. Commercial entertainment and recreation excluding such uses with an ancillary bar or lounge.
- e. Cultural institutions

2. All residential development, with or without a new commercial component, is allowed with a conditional use permit.

3. The City has determined that residential uses on the Capitola Mall property consistent with this chapter and Chapter 17.57 (Objective Design Standards for Capitola Mall Redevelopment) are in compliance with the City’s General Plan and are conditionally allowed in the CR zoning district. Therefore, the City’s review of a Conditional Use Permit for residential development on the Capitola Mall property shall focus on requiring conditions related to the following considerations, provided that such conditions do shall not deny the residential development project or reduce project density:

- a. Interior site layout (e.g., arrangement and configuration of different uses, public open space, and structures).
- b. Site access and internal circulation.
- c. Operating characteristics (hours of operation, traffic generation, lighting, noise, odor, dust, and other external impacts).
- d. Public services and infrastructure.
- e. Project phasing.
- f. Property maintenance.

~~43.~~ On a Housing Element Site, a project ~~with a density of less than 20 units per acre and/or with~~ less than 50 percent of the new floor area occupied by residential uses is prohibited.

Item 2. 17.57.040.B

B. Deviations.

1. In addition or as an alternative to incentives, concessions, waivers, and/or parking reductions available to housing development projects that meet the criteria specified in State Density Bonus Law (Government Code Section 65915), ~~A~~an applicant may request deviation from one or more standards in this chapter through the design permit process. The planning commission may approve a deviation upon finding that:

- a. The project incorporates an alternative method to achieve the intent statement that proceeds the standard; and



b. The request~~ed~~ is needed due to unique site conditions and/or to provide for a superior project design.

2. A project requesting a deviation pursuant to this Section 17.57.040.B shall not be considered consistent with applicable, objective development standards for the purposes of qualifying for is not eligible for streamlined approval under Government Code Section 65913.4, Government Code Chapter 4.1, or other state laws providing a ministerial approval process for qualifying projects consistent with applicable, objective development standards. This paragraph does not apply to any benefits or modifications approved pursuant to the State Density Bonus Law (Government Code: Code Section: 65915).

Note: No new edits to item 2 since publication on January 30, 2026. Concerns raised by HCD were addressed in most recent publication in #2 as identified in “HCD edit”

Item 3. 17.24.035.F

F. Fiscal Impact Analysis.

1. **When Required.** A Fiscal Impact Analysis (FIA) is required in connection with the application for any proposed development project with new residential uses on the Capitola Mall property, except that an FIA is not required for a stand-alone 100 percent affordable housing development project.

2. **Contents of Fiscal Impact Analysis.**

a. Each FIA shall include, at a minimum:

1. An estimate of the incremental change to annual recurring revenues and expenditures to the City generated by the project at buildout, including but not limited to property tax, sales tax, transient occupancy tax, and service costs (police, public works, parks, administration).
2. Identification of any net fiscal surplus or deficit to the City’s General Fund and special revenue funds over 10, 15, and 20-year horizons.
3. A description of proposed mitigation measures or financing mechanisms (e.g., community facilities district, development agreement contributions) to offset any projected negative fiscal impact.
4. Supporting assumptions, data sources, and methodology.

b. The FIA shall consider City cost implications resulting from publicly accessible open space, maintained by the property owner and not the City, provided in the proposed development.

3. **Review and Approval.**

- a. The applicant shall submit for City review a FIA prepared by a qualified economic consultant concurrently with the applicant’s submittal of a development application.
- b. The applicant’s FIA shall be peer reviewed by a qualified independent economic consultant hired by the City and funded by the applicant.
- c. Based on the results of the peer and City review of the FIA, the City may require revisions to the FIA analysis assumptions, data sources, and methodology.
- d. When reviewing and acting on the proposed development project, tThe City shall consider the findings of the FIA to inform the decision-making body about future land use and planning decisions that may be necessary in response to the proposed development project's fiscal impacts ~~when reviewing and acting on the proposed development project.~~ The findings of an FIA shall not be used as a basis to deny or reduce the density of a housing project.



Herlihy, Katie (kherlihy@ci.capitola.ca.us)

From: Thomas, Xjvirr@HCD <Xjvirr.Thomas@hcd.ca.gov>
Sent: Friday, January 30, 2026 2:14 PM
To: Herlihy, Katie (kherlihy@ci.capitola.ca.us); Heaton, Brian@HCD; McDougall, Paul@HCD
Cc: Ben Noble; Phillips, Eric S.; Herrera, Fidel@HCD
Subject: RE: Technical Complaint Follow-Up

Good Afternoon Katie,

Thank you for the email and for sitting down with us the other day to discuss the City's plans for the Capitola Mall area. After discussing the matter with Brian, Paul, and our Section Chief over Housing Element Implementation (Fidel Herrera), HCD would like to see the following changes/refinements be added to the code amendments that will be presented to your Planning Commission February 5. The following build upon the suggestions made by the City your previous email:

City Suggestion 1: Insert additional references throughout the draft code to emphasize the purpose of the amendments are to facilitate a mixed-use housing development and support for housing (and particularly affordable housing) production consistent with the Housing Element's programs.

- HCD Response Recommendation: In the Land Use Regulation section, clarifying that more certain parameters could be granted for Conditional Use Permit (CUP) submittals for affordable housing projects or projects that consist of majority of residential units. We recognize the need for discretion with such a large and complex property but also suggest adding parameters on the CUP process to promote approval certainty. This could be accomplished via an alternative permit type such as a Minor Use Permit (MUP) or Site Plan Review that provides an applicant more certainty than the existing CUP process. The CUP process could also be refined to provide decision-making parameters such as access, circulation, etc. The idea is to focus the deliberation and not rove into unnecessary areas. If not amenable to this approach, consider other approaches to promote approval certainty in the CUP process. This would demonstrate a predictable and prioritized permitting pathway for residential developments which syncs the City's proposed actions with the commitments made in Program 1.7 of the Housing Element.

City Suggestion 2: Clarify that the "deviation" section of the objective standards is only applicable to projects that are not eligible for or do not seek incentives, concessions, or waivers under the state density bonus law and that a request for a deviation (outside of the state density bonus law context) means that the project is not consistent with applicable, objective standards without concluding that no state streamlining laws are applicable (17.57.040.B).

- HCD Response Recommendation: The City should reconsider the necessity of the provision at 17.57.040(B)(2) altogether. It is redundant (and possibly confusing for applicants and decision makers) to state that a housing development project is not eligible for the benefits and protections of state housing law for which it does not qualify. HCD recommends rephrasing it to a positive, such as, "Requesting a deviation does not limit a housing development project's ability to use the benefits and protections of State housing laws for which it is eligible, including specifically State Density Bonus Law incentives, concessions, and development standard waivers."

City Suggestion 3: To reduce entitlement costs, waive Fiscal Impact Analysis (FIA) requirements for stand-alone 100% affordable housing projects. Consider whether an FIA waiver may also be appropriate for projects that include a minimum threshold of commercial development (17.24.035.E).

- HCD Response Recommendation: Exempting 100% affordable housing projects from the requirement to provide an FIA is a good start. However, HCD recommends that the City reconsider the benefit of requiring FIAs for any 100% residential projects. It's well known that ongoing costs to provide services (e.g., police, fire, etc.) to residential land uses generally exceeds the tax revenue generated by these uses. Without directive language in the municipal code, decisionmakers might inappropriately attempt to reduce residential unit counts in mixed-use projects in an attempt to make the projects revenue neutral (per 17.24.035 (E)(2)(c), which relates to need to "offset any negative fiscal impacts". As you are aware, the Housing Accountability Act strictly limits the ability of a local government to reduce the density of a qualifying housing development project. To best implement Housing Element Implementation Program 1.7, the City should exempt all 100% residential projects from this requirement. The City should also add language stating that anticipated increases in City expenditures generated by residential projects/projects components at buildout cannot be used to justify a reduction in the residential units/residential floor area in a proposed project.

Thank you



Xjvirr Thomas

HCD Specialist II

Housing & Community Development

651 Bannon St. | Sacramento, CA 95811

Email: Xjvirr.Thomas@hcd.ca.gov



From: Herlihy, Katie (kherlihy@ci.capitola.ca.us) <kherlihy@ci.capitola.ca.us>

Sent: Wednesday, January 28, 2026 10:01 AM

To: Thomas, Xjvirr@HCD <Xjvirr.Thomas@hcd.ca.gov>; Heaton, Brian@HCD <Brian.Heaton@hcd.ca.gov>; McDougall, Paul@HCD <Paul.McDougall@hcd.ca.gov>

Cc: Ben Noble <bnoble@bnplanning.com>; Phillips, Eric S. <EPhillips@bwslaw.com>

Subject: Technical Complaint Follow-Up

Dear Xjvirr, Brian, and Paul,

Thank you again for taking the time to meet with Eric, Ben, and me to walk through the technical complaint HCD received related to the Capitola Mall zoning code amendments. We appreciate the opportunity to discuss your review in detail and appreciate your guidance on paths forward.

As a brief update, the Capitola Planning Commission is scheduled to meet on February 5, 2026, at 6:00 p.m. to review the most recent updates to the zoning code amendments and may make a recommendation to the City Council at that meeting.

In the interest of time and in advance of that discussion, we have put together a list of edits to the draft code that we will incorporate before releasing our next public review draft for the February 5 Planning Commission meeting, which are intended to address the topics discussed during our meeting. These include:

1. Insert additional references throughout the draft code to emphasize the purpose of the amendments are to facilitate a mixed-use housing development and support for housing (and particularly affordable housing) production consistent with the Housing Element's programs.
2. Clarify that the "deviation" section of the objective standards is only applicable to projects that are not eligible for or do not seek incentives, concessions, or waivers under the state density bonus law and that a request for a deviation (outside of the state density bonus law context) means that the project is not consistent with applicable, objective standards without concluding that no state streamlining laws are applicable (17.57.040.B).
3. To reduce entitlement costs, waive Fiscal Impact Analysis (FIA) requirements for stand-alone 100% affordable housing projects. Consider whether an FIA waiver may also be appropriate for projects that include a minimum threshold of commercial development (17.24.035.E).

Please consider these modifications as you determine what further guidance HCD may provide in advance of our Planning Commission hearing.

Thank you again for your time and collaboration. We look forward to continuing to work with you as we move this forward.

Best regards,

Katie Herlihy, AICP
Community & Economic Development Director

City of Capitola
420 Capitola Avenue, Capitola, CA 95010
831.475.7300 ext. 216

