

# The Impact of Vacation Rentals on Affordable and Workforce Housing in Sonoma County

*The Economics of Land Use*



Prepared for:

The Sonoma County Community Development Commission

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## *INTRODUCTION AND SUMMARY*

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This Research Paper was commissioned by the Sonoma County Community Development Commission as part of its broader efforts to address homelessness, the inadequate supply of rental housing, and the rapidly increasing rents in Sonoma County. This Paper explores one aspect of housing supply constraints and increasing costs—the rapid expansion and emerging effects of “vacation rentals,” some of which compete directly for available housing by shifting housing units from residential use to visitor-serving use. Vacation rental use of housing units has increased rapidly in recent years due to the advent of web-based vacation rental marketing platforms such as AirBnB and VRBO; the growth of the industry is expected to continue in the coming years. This Paper quantifies and locates this shift of housing from residential use to visitor-serving use that has already occurred, and recommends ways of minimizing and mitigating the impacts of vacation rentals that impinge on the County’s housing supply.

Homelessness and lack of an adequate supply of affordable housing in Sonoma County have many causes. This Paper concludes that expansion of vacation rentals in Sonoma County, especially the component of the market involving rental of whole housing units in areas not historically associated with vacation rentals, is reducing the supply of housing available to the resident workforce market. This reduction in housing supply, in turn, has and will continue to contribute to upward pressure on residential rents and prices.

The research conducted in support of this paper included review of the substantial literature on the topic of vacation rental impacts, assessment of the current vacation rental market based upon “webscrapes” of the data available from the largest vacation rental platform (AirBnB), obtaining housing data from US Census sources and commercial sources, and finally, use of data and mapping resources developed by Sonoma County Permit & Resource Management Department (PRMD) as part of their broader research on the topic.

## **Background**

### **History of Sonoma County as a Visitor Destination**

Sonoma County has been a recreation and resort-destination since the late 19<sup>th</sup> century. At that time, the burgeoning growth of San Francisco and other more central Bay Area cities created demand for close-by destination recreation and resorts. Simultaneously, the expanding San Francisco Bay ferry system and railroads made access to the Russian River area and the hot springs resorts in the Sonoma Valley an easy day-trip for San Francisco residents. Over the years, as the advent of the automobile, improved highway access, bridges, and air travel provided easier access to more distant recreation and resort venues, the old resort communities of Sonoma County lost their luster. Beginning in the post-war years’ suburban expansion of Sonoma County, its historical resort communities increasingly shifted to serving local residents, both as a source of housing and local recreation.

In recent decades, with the continued population growth of the Bay Area region and the expansion of the wine industry, Sonoma County has once again emerged as a significant visitor destination. Visitors are attracted to the County’s lovely coastline and coastal communities; its expanded and improved State and regional park system; its scenic highways; and its lodging and resort properties concentrated along the Sonoma Coast, the Russian River corridor, the Sonoma

Valley, and the north County wine region. At the present time some 7.5 million visitors arrive in Sonoma County each year <sup>1</sup> driving continued expansion of the County's tourist-serving businesses.

### **Increasing Destination Visitors and the new Web-Based Marketing Platforms**

While vacation rentals have historically been a part of lodging supply in the Russian River resort areas, short-term vacation rentals have expanded rapidly in recent years mirroring the national and international trend. With the new web-based platforms, hosts can now make a spare room, an entire apartment, or a house available to potential visitors through websites such as AirBnB, Homeaway, Flipkey and other vacation rental "platforms." These platform companies have varying business models but generally earn fees when bookings occur and/or when listings are posted by hosts. Unlike a hotel, bed and breakfast inn, or a traditional vacation rental unit, making residential owner's space available for short-term rentals is a low-cost and flexible undertaking for a host. The host can earn income by renting their space for as few or as many nights as they wish and that the market will bear. Using web-based vacation rental platforms, visitors to the County can select from a variety of lodging options and have the experience of staying in a home and neighborhood not traditionally oriented to tourist accommodations.

The advent of the new web-based marketing platforms coincides with considerable growth in visitors to the County and a corresponding increase in related economic activity and tax income to local governments. Over the past five years, as the economy has been recovering from the Great Recession, the transient occupancy taxes (TOT) by Sonoma County (unincorporated County lodging) increased to \$12 million in 2014, a nearly 60 percent increase in five years. TOT gains recorded by the cities were more modest during this period. Total visitor spending is estimated at \$1.6 billion, total related local tax revenues at \$143 million and total employment supported at 19,350 jobs.<sup>2</sup>

Visitors to Sonoma County are estimated to be 90 percent of domestic origin with the largest fraction arriving from other Bay Area counties. An increasing number of visitors are international, corresponding to the substantial growth in international tourism globally and specifically to the growth in California's attractiveness to international tourists.<sup>3</sup> These growth trends suggest potential for continued expansion of the County's tourism business, including lodging demand and further expansion of the vacation rentals as a component of the County's lodging supply.

### **Increasing Investment in Housing for Second Home and Vacation Rental Purposes**

The increasing visitor demand and the improved ability to market homes as vacation rentals has made homes in visitor-serving areas a target for investment by companies and individuals seeking investment opportunities. These investors include an increasing number of international investors, dominated by those from Asia and Canada. The National Association of Realtors has recently reported that foreign investment in housing in the United States is expected to top

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<sup>1</sup> Annual Tourism Report 2014, Sonoma County Economic Development Board

<sup>2</sup> Ibid

<sup>3</sup> Ibid

\$100 billion in 2015 with this investment focused in the coastal metropolitan areas and high-amenity locations such as Sonoma County. Over 50 percent of this investment appears to be for second home or vacation rental purposes (not primary residence).<sup>4</sup> This information conforms to data, discussed later in this Paper, showing an increasing shift of housing units in Sonoma County to second homes and seasonal (vacation rental) uses.

### **Workforce Housing Supply Constraints**

While the tourism sector has rebounded from the Great Recession, overall economic indicators in the County, including increases in household income and new employment, have been less strong. While employment increased by about 10 percent (18,800 jobs) between 2009 and 2015, most new jobs were created in the lower wage categories of the service sector whose average earnings per employee in 2014 were less than \$30,000.<sup>5</sup> Meanwhile median household income in the County, at approximately \$64,000, has remained essentially flat during this period. Adding to the existing housing supply constraints, the new service sector workers affiliated with the expanding visitor-serving businesses (lodging, food service, recreational services, etc.) will need housing. These housing demand trends, along with supply constraints including capacity and development-cost-related constraints and tightened credit and lending standards, have resulted in a weak rebound of the real estate sector in the County. As a result and mirroring trends throughout California, Sonoma County residents have shifted away from ownership housing toward rentals, resulting in additional demand for the limited rental housing stock. This shift can be explained by limited production of for-sale housing, as well as by tenure preferences related to both the aging population and the lower income profile of new household formations. Sonoma County needs more rental housing than ever to keep up with its changing demographics and workforce expansion.

As a result of the increasing demand for rental housing and only limited production of new housing units in the County, rents have increased by 30 percent or more in the County over the past few years and rental vacancy rates, currently estimated to be below 2 percent, are well below a “normal” market vacancy rate of 5 percent. Even though home prices and rents have increased substantially in recent years following the contraction that occurred during the Great Recession, they have not, as evidenced by the very limited housing production in the County, been sufficient to stimulate substantial new construction (other factors including limited land availability and proportionately high entitlement costs and development impact fees charged individually by the County in unincorporated areas and the nine cities may also contribute to the poor rebound of the home construction industry). These housing supply trends underscore the need to preserve the existing housing stock otherwise available to the County’s working families.

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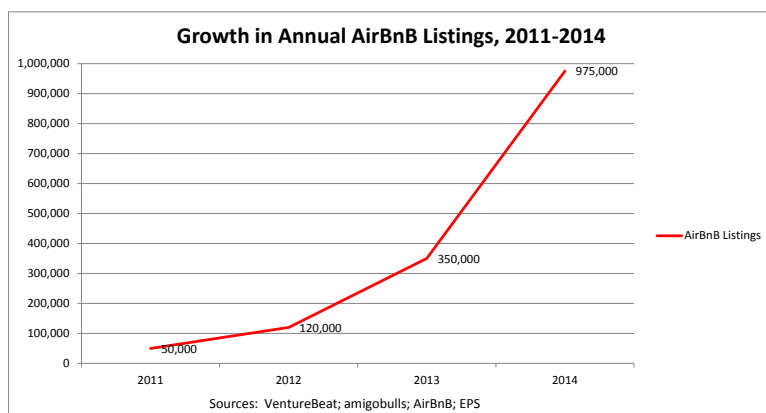
<sup>4</sup> National Association of Realtors, 2015

<sup>5</sup> Ibid

## Findings

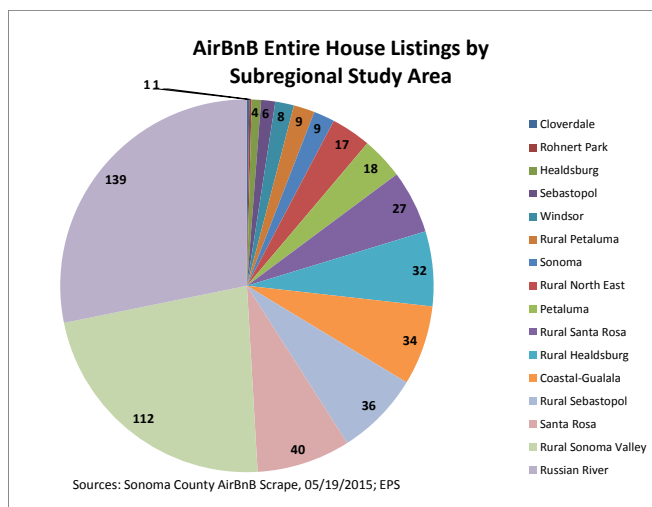
### 1. Vacation rentals are a rapidly increasing component of visitor accommodations nationwide and in Sonoma County.

Since its advent in 2008 AirBnB, now joined by other competing web-based vacation home marketing platforms, has grown very rapidly with no sign of the growth slowing down. This lodging business trend is caused by a variety of factors including an improving economy and related increases in tourism, a substantial price advantage to vacation home rentals by comparison to traditional lodging properties in the same market area, and the convenience offered by the web-based searching and transaction marketing platforms. While precise time-series data is not available, growth of AirBnB in Sonoma County appears to have mirrored the rate of national growth.



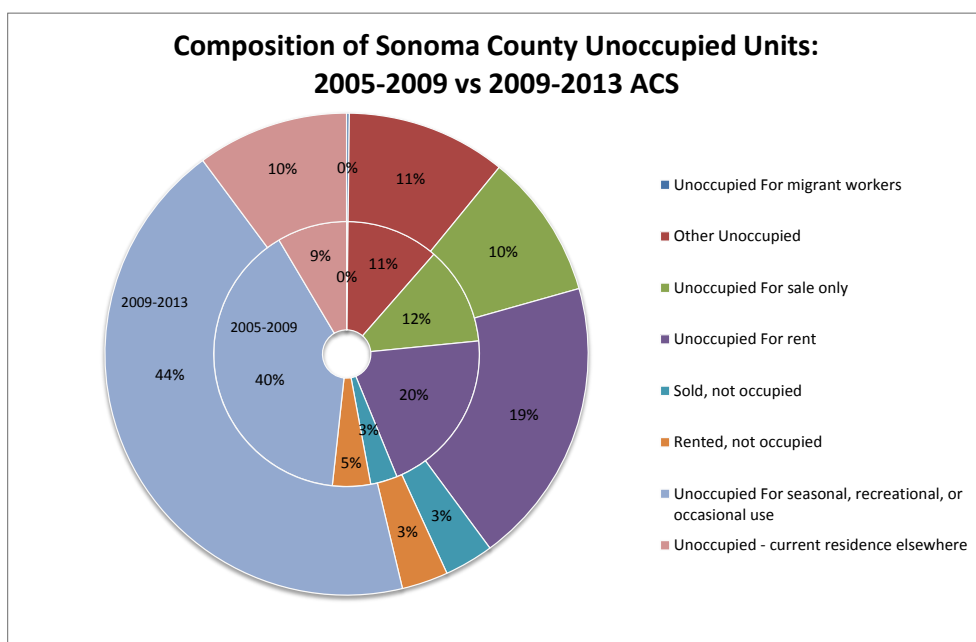
### 2. The vacation rental marketing platforms have effectively incorporated single-family homes in residential neighborhoods to the County's lodging rental unit pool, thus competing with local residents for these units.

While vacation rentals have long been a component of the County's lodging industry, especially evident along the Sonoma Coast in places such as Sea Ranch and Bodega Harbor, the web-based marketing platforms have extended the reach of the industry to the County's other visitor-serving areas, including encroaching into traditionally residential neighborhoods in the Russian River area, in the Sonoma Valley, and in the north County surrounding Healdsburg.



**3. There is a measurable shift in housing supply, otherwise available to the County's working families, to vacation rentals and other nonresident serving uses.**

While precise current statistics are not available tracking units in the vacation rental pool, trends in "unoccupied housing units" as reported by the US Census American Community Survey (ACS), indicate that the number of units so identified increased by 1,800 units between 2005 and 2103. Within the components of "unoccupied housing units," the two categories closely aligned with vacation rentals, the unoccupied/owner living elsewhere and seasonal units equaled 54 percent of all unoccupied units in the County in 2013, a total of over 10,400 units. Given the rapid increase in vacation rental listings it is likely that these categories of "unoccupied housing units" continued to increase since 2013. The very limited amount of new housing construction during this period means that these increasing "unoccupied housing units" have been drawn from housing supply otherwise available to the County's working families.



**4. Additional regulation and mitigation can limit the loss of housing units otherwise available to the County's working families.**

The shift of workforce housing to vacation rentals that has already occurred along with the expectation for the continued rapid growth of the vacation rental industry in Sonoma County suggests that additional regulations and mitigation measures are in order to protect the County's supply of housing available to local working families. The County should consider both new regulations to reduce future shifts of workforce housing to vacation rentals and also establish mitigation efforts to offset the existing and future impacts of vacation rentals on the County's housing supply.

- Regulatory changes (changes to the County's Zoning Ordinance regulations) can reduce the conversion of housing stock in neighborhoods where single-family housing otherwise available to local working families is susceptible to vacation rental conversion. A multi-pronged regulatory approach is recommended, as outlined in the final section of this Paper.



- Providing County funding to programs that stimulate production of workforce housing can offset housing losses that have and will occur in the future. Dedicating a portion of existing (or an additional increment of) transient occupancy taxes levied upon vacation rentals in the County could provide such a funding source. For example, such a program could be created to pre-pay certain development costs (i.e., permit and development impact fees) and invest in measures that increase development readiness of designated housing sites.

# ASSESSING THE COUNTY'S VACATION RENTAL INDUSTRY

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## **Vacation rentals and the hospitality industry**

### **Short-term Rental Market**

The short-term rental market has three participants: 1) the host who rents their property, 2) the guest who rents the property on a short-term (e.g., vacation) basis, and 3) the web-based rental platform that serves as a clearing house and rental agency for the hosts and guests. The host may be a property owner, lease holder, or a third party management company that owns or offers individual private rooms or whole houses or apartments. The guests rent out these lodging units based on their needs and preferences, and the rental platform company facilitates the exchange between the hosts and guests and also earns a fee from the hosts for the services rendered.

Short-term rentals are a substitute to traditional lodging, offering a new lodging product that includes amenities such as full kitchens, easy access to different neighborhoods, and an opportunity for a more local and familiar experience of the destination. While vacation rentals offer occupant-owners of housing units the opportunity to gain income from renting out spare rooms or secondary units, the industry has also attracted investors who have focused on acquiring and renting out whole residential units, including single-family homes and multifamily units.

The web-based rental platforms generate revenue in a variety of ways. AirBnB, the predominant web-based rental platform in Sonoma County, generates revenue by charging hosts a 3 percent commission on each booking and by charging travelers a commission of between 6 and 12 percent, thus generating a yield of anywhere between 9 and 15 percent in commission for every booking. Other vacation rental platforms such as HomeAway and FlipKey offer a pay-per-booking option and also a subscription model, which charges hosts for advertising rentals. This report focuses on AirBnB due to its predominance in the short-term rental market and the availability of public data on its activities.

Web-based rental platforms are now a global industry which has grown rapidly from the creation of AirBnB in San Francisco in 2008. In the past year AirBnB has raised nearly \$800 million from global investment firms including TPG Capital, T. Rowe Price and Dragoneer Investment Group. AirBnB has been valued at \$13 billion, placing the company in the upper echelons of the hospitality industry. At this valuation, AirBnB has a higher market value than both Hyatt (\$8.4 billion) and Wyndham (\$9.3 billion). According to media reports, the company has been responsible for booking 10 million guest nights since 2008, and its own estimates indicate the company may have booked more room nights in 2014 than major chains like Hilton and Intercontinental.

### **Classification of vacation rental units**

Vacation rentals offer a variety of lodging products, expanding upon the historical supply of second homes and other units dedicated to the vacation rental market such as those located at Sea Ranch, Bodega Harbor, or in the Russian River area. It is this expansion of vacation rentals into historically residential neighborhoods that creates neighborhood conflicts and competition

with the rental housing market. The AirBnB website offers three types of rentals: 1) entire homes where the guest has access to the entire unit and the host is generally not present, 2) private rooms where the host is often present in the home, and 3) shared rooms, where hosts or other guests may sleep in the same room.

Of these three types of rentals it is the first type (the entire homes are rented without the host being present) that has the most potential to compete for the workforce housing supply. At the present time these entire home vacation rentals comprise 51 percent of AirBnB's listings in Sonoma County.

## **Benefits and Costs of Vacation Rentals**

Numerous studies have been prepared in recent years addressing the benefits and costs of the short-term rental market.<sup>6</sup> On the "benefit" side, some say that the short-term rental market can 1) increase tourism and its related economic and fiscal benefits; 2) provide additional income for hosts, particularly those who could not otherwise rent their home or rooms; and 3) extend the economic benefits of tourism (increased sales, etc.) to neighborhoods traditionally not visited.

On the "cost" side, the literature indicates that short-term rentals can: 1) shift existing scarce local resident housing to the lodging sector, 2) encourage tenant evictions if a landlord concludes that they can earn more money from short-term rentals than from a long-term tenant, 3) violate local zoning and other ordinances, 4) negatively affect the quality of life in residential areas due to nuisances caused by visitors, and 5) cause loss of household population in given neighborhoods thus reducing the number of school children and residents available for volunteer services such as fire protection. It is the first two of these impacts, where short-term rentals exacerbate the housing shortage in Sonoma County by offering a more lucrative alternative to offering a unit on the long-term rental market that is the concern of this Paper.

## **Location of Sonoma County's Vacation Rentals**

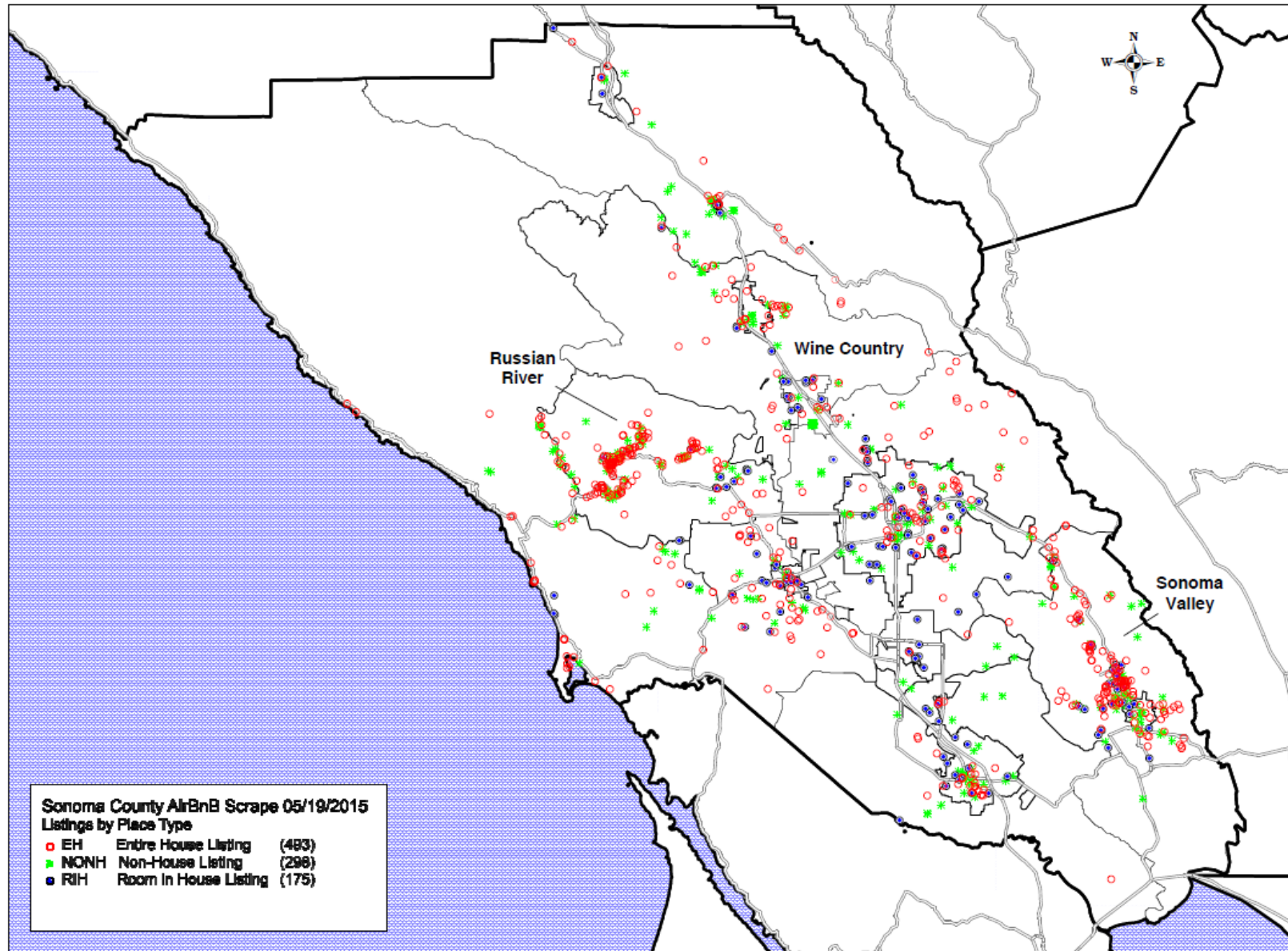
The nature of the vacation rental industry in the wake of the web-based rental platforms can make it difficult to measure the actual number and types of properties offered for rent. While the County (and some cities) require registration of vacation rental units pursuant to local ordinances, such as Sonoma County's Ordinance 5908, registration and compliance with these ordinances is by no means universal, as it tends to be with the traditional lodging sector. Given this data gap, this Paper relies upon AirBnB as a source of data and proxy for the total number and distribution of the vacation rental units in the County.

**Figure 1** shows the geographic distribution and quantity of vacation rentals derived from webscrapes of AirBnB's website in May 2015. The three classes of vacation rentals offered by AirBnB are shown. While it is likely that there are more vacation rentals than indicated through this single data source, it is likely that the pattern of their distribution will be consistent.

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<sup>6</sup> See Bibliography

Figure 1 AirBnB Listings for Sonoma County, Mid-May 2015



**Table 1** shows the numbers of AirBnB-listed vacation rental units by County sub-areas. It is notable that the AirBnB vacation rental listings (excluding the Coastal communities) are concentrated in three locations: the Sonoma Valley, the Russian River, and the north County “wine country” surrounding Healdsburg. This distribution is very relevant to impact upon residential supply because these areas are the location of stable residential neighborhoods that provide housing for the County’s working families. While the Russian River resort area has attracted visitors with vacation homes in the past, many river-area homes provide long-term housing that is more affordable than in many other areas of the County. Similarly, the incursion of vacation home rentals into the traditional residential neighborhoods in the Sonoma Valley and areas surrounding Healdsburg has caused a loss of housing stock that was formerly available for working residents; a loss that is likely to increase given the rapid growth trends of web-based vacation rental marketing.

**Table 1 AirBnB Listings by Sonoma County Subregional Study Area**

Geography	Estimate; Total AirBnB Listings		Estimate; Entire House Listings		Estimate; Room in House Listings		Estimate; Non- House Listings	
	#	%	#	%	#	%	#	%
Russian River	207	21%	139	14%	12	1%	56	6%
Rural Sonoma Valley	179	19%	112	12%	26	3%	41	4%
Santa Rosa	110	11%	40	4%	41	4%	29	3%
Rural Sebastopol	58	6%	36	4%	10	1%	12	1%
Coastal-Gualala	59	6%	34	4%	4	0%	21	2%
Rural Healdsburg	50	5%	32	3%	4	0%	14	1%
Rural Santa Rosa	55	6%	27	3%	13	1%	15	2%
Petaluma	45	5%	18	2%	11	1%	16	2%
Rural North East	54	6%	17	2%	12	1%	25	3%
Sonoma	26	3%	9	1%	5	1%	12	1%
Rural Petaluma	23	2%	9	1%	6	1%	8	1%
Windsor	49	5%	8	1%	12	1%	29	3%
Sebastopol	18	2%	6	1%	7	1%	5	1%
Healdsburg	12	1%	4	0%	0	0%	8	1%
Cloverdale	5	1%	1	0%	2	0%	2	0%
Rohnert Park	9	1%	1	0%	8	1%	0	0%
Cotati	1	0%	0	0%	0	0%	1	0%
Rural Rohnert Park-Cotati	6	1%	0	0%	2	0%	4	0%
<b>Sonoma County Totals</b>	<b>966</b>	<b>100%</b>	<b>493</b>	<b>51%</b>	<b>175</b>	<b>18%</b>	<b>298</b>	<b>31%</b>

Sources: Sonoma County AirBnB Scrape, 05/19/2015; ABAG Subregional Study Area Map

## **Current Regulation and Taxation**

The County adopted a Vacation Rental Ordinance in 2010 that became effective on the first day of 2011. The Ordinance established regulatory requirements including the need to obtain a zoning permit, limits on per room occupancy, controls on nuisance, and subjecting the vacation rentals to the County's 9 percent Transient Occupancy Tax.

More recently, in October 2014 the Board of Supervisors received a report on the TOT Program that included an audit report prepared by the County Auditor-Controller on transient occupancy tax revenue and a report on the growth and issues associated with vacation rentals. As a result of these reports, the Board adopted a Resolution of Intention to initiate amendments to the County's vacation rental ordinance to further regulate this land use. The Board requested more information on the location of permitted vacation rentals by district, number and type of complaints, and actual violations. The Board stressed that a robust public outreach and community engagement program should be undertaken in evaluating the effectiveness of the current ordinance and the options for Ordinance amendments or other measures. In addition, the Board provided direction to staff to evaluate and address a number of enforcement issues including coordination with web-based platforms to assist in collection of transient occupancy taxes.

## **Housing Supply Shifts to Vacation Rentals**

Historically, the rental housing market and the hospitality industry did not compete for the same supply. The web-based vacation rental platforms now allow residential property owners to compete for tourist lodging demand. Owners can often earn more money by converting traditional residential housing units into vacation rental units, as many appear to have done. The analysis of AirBnB's impact on housing supply in Los Angeles <sup>7</sup>estimates that an owner can expect to earn double or more in annual rental income through short-term rental versus renting to local residents at current market rates. As noted above, it appears that this trend is leading investors to purchase heretofore single-family homes expressly for use as vacation rentals. Such investors are also known to form Limited Liability Corporations (LLCs) to hold these properties and only sell shares rather than transferring property ownership, thus limiting real estate tax increases.

Sonoma County cannot afford to lose its housing units. During the most recent Housing Element cycle (2007-2014), the County produced only 412 housing units affordable to families of moderate or low income, about 50 percent of the need expressed in the Regional Housing Needs Allocation (RHNA). Going forward in the Housing Element 2014-2023 cycle the County needs an additional 936 units, of which 513 must be affordable. Actual demand for housing units, based upon continuing household formation rates, is far greater than the RHNA numbers.

Existing housing supply statistics for Sonoma County sub-areas are offered by the American Community Survey (ACS) data conducted by the U.S. Census Bureau. These surveys are conducted every five years and provide details regarding the quantity and tenure status of housing, typically by county sub-areas throughout the United States.

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<sup>7</sup> Rising Rent, and the Housing Crisis in Los Angeles, Samaan, Roy, LAANE, 2015

## **Unoccupied Housing in Unincorporated County**

Data provided by the US Census American Community Survey (ACS) provide a useful measure of housing stock trends. The survey based data is updated annually and is summarized in five-year averages. The ACS classifies a portion of the housing as "vacant" for a variety of reasons. These reasons include, but are not limited to, the more narrow meaning of "vacant" (available for rent or sale on the open market). The other categories include units that have been rented or sold but not yet occupied; homes available for seasonal, recreational, or occasional use; and finally, vacant for other reasons.

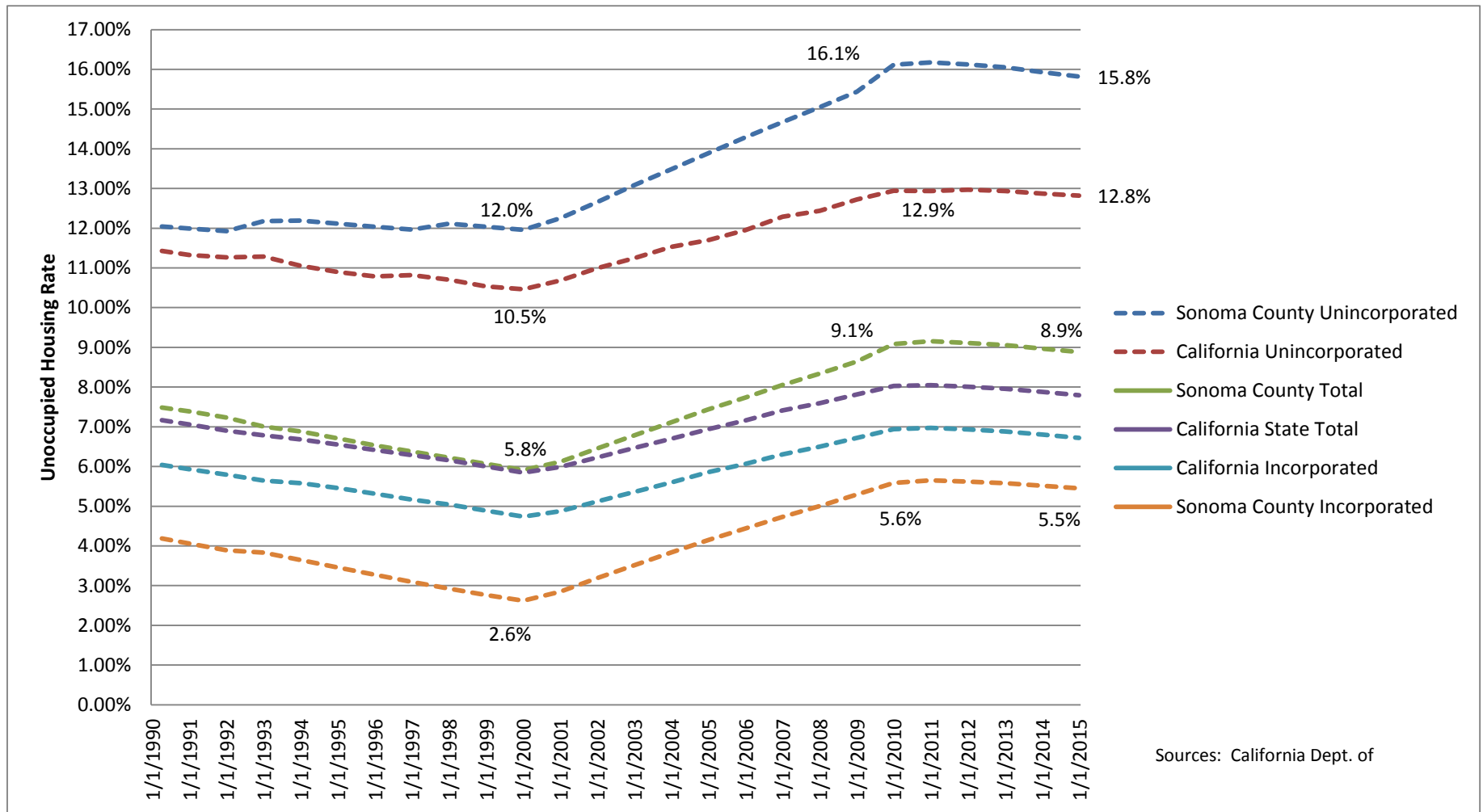
Trends in these unoccupied housing categories provide a framework for measuring the effects of vacation rentals on the County's housing stock. During the past decade, as indicated by the ACS data, there has been an increase in the total unoccupied housing in unincorporated Sonoma County, despite there being a historically tight housing market as indicated by very low vacancy rates for rental housing. **Figure 2** shows trends in unoccupied units in the County including those in the unincorporated areas and the cities and as compared to statewide averages. While the percent of unoccupied housing units in Sonoma County's cities remains below the statewide average, perhaps reflecting the tight housing market conditions and the lower percentage of units devoted to seasonal, recreational, or occasional use, the County's unincorporated areas show a rate of unoccupied units higher and increasing faster than the statewide average.

Seasonal, recreational, or occasional use units, which include vacation rental units, comprise the largest share of total unoccupied units in Sonoma County and have steadily increased as a percentage of unoccupied units since 2005. As measured by the survey-based ACS, they are now approximately 44 percent of total unoccupied units in the County, an increase of 1,761 units or about 20 percent during this period, which can be assumed to be a proportional reduction in for sale or rental housing available to the County's working families.

Additionally, unoccupied units owned by persons who have fixed residences elsewhere (and are not presently declared as seasonal units or units available for sale or rent) equal 1,970 units, approximately 10 percent of the total unoccupied units. In combination the unoccupied/owner living elsewhere and seasonal units equal 54 percent of all unoccupied units in the County, some 10,400 units as of 2013. **Figure 3** shows the composition of unoccupied units in the County numerically, while **Figure 4** shows the same data in percentage terms. This increase in housing units devoted to seasonal, recreational, or occasional use along with the increasing unoccupied absentee owner units have largely been shifted from the residential rental occupied or owner-occupied units; i.e., a reduction in the housing supply, as shown in **Figure 2**. Census and California Department of Finance housing reports indicate that over the last 15 years, since a (comparatively) high point in housing occupancy rates circa 2000, unoccupied units have been increasing at more than 5 times the rate of growth in total housing supply for Sonoma County.

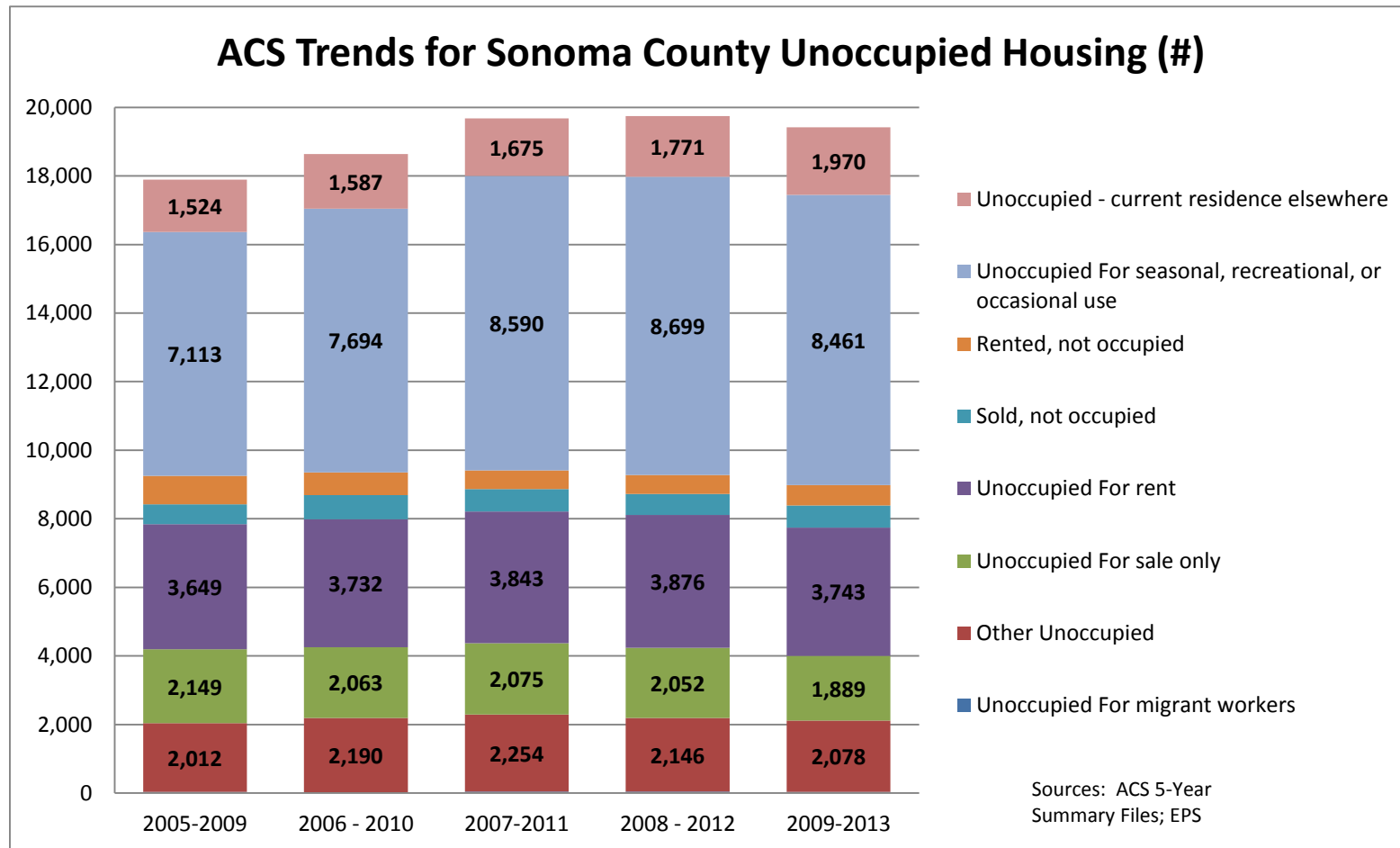
An emerging trend is the increase in Sonoma County housing held not only for investment and equity, but as income-generating real estate. The recent AirBnB 'scrape' of listings for Sonoma County produced several examples of multiple units offered by a single host. While some of these were obviously postings by well-established vacation rental agencies, others appear to be held by out-of-town investor groups. AirBnB and similar sites have facilitated the use of Sonoma County housing units for short-term rentals beyond and outside of traditional vacation, lodging and rental real estate owners and operators, contributing to the loss of available units as documented above.

**Figure 2 Changes in California and Sonoma County Unoccupied Housing Rates 1990-2015**

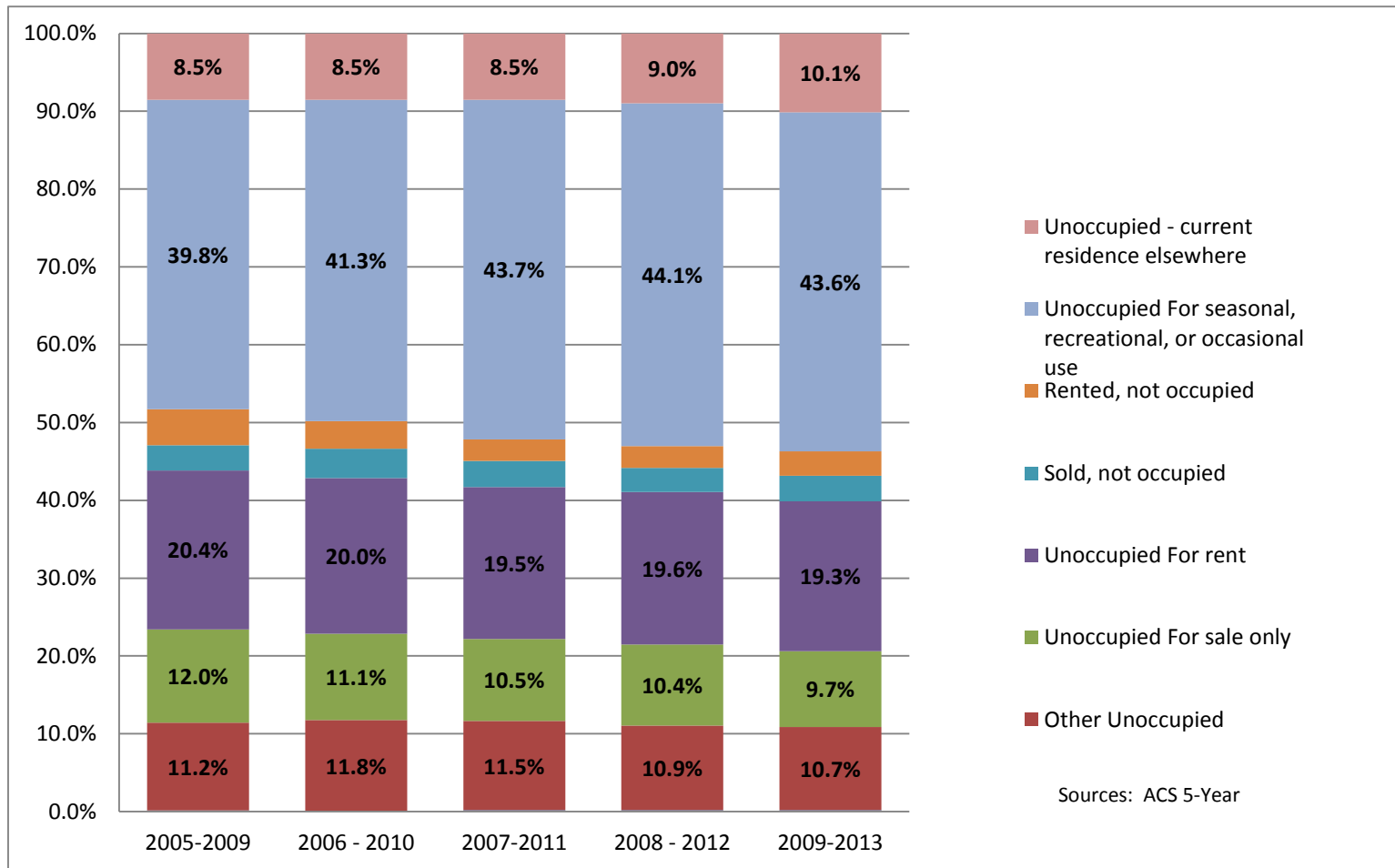




**Figure 3 ACS Trends for Sonoma County Unoccupied Units (#)**

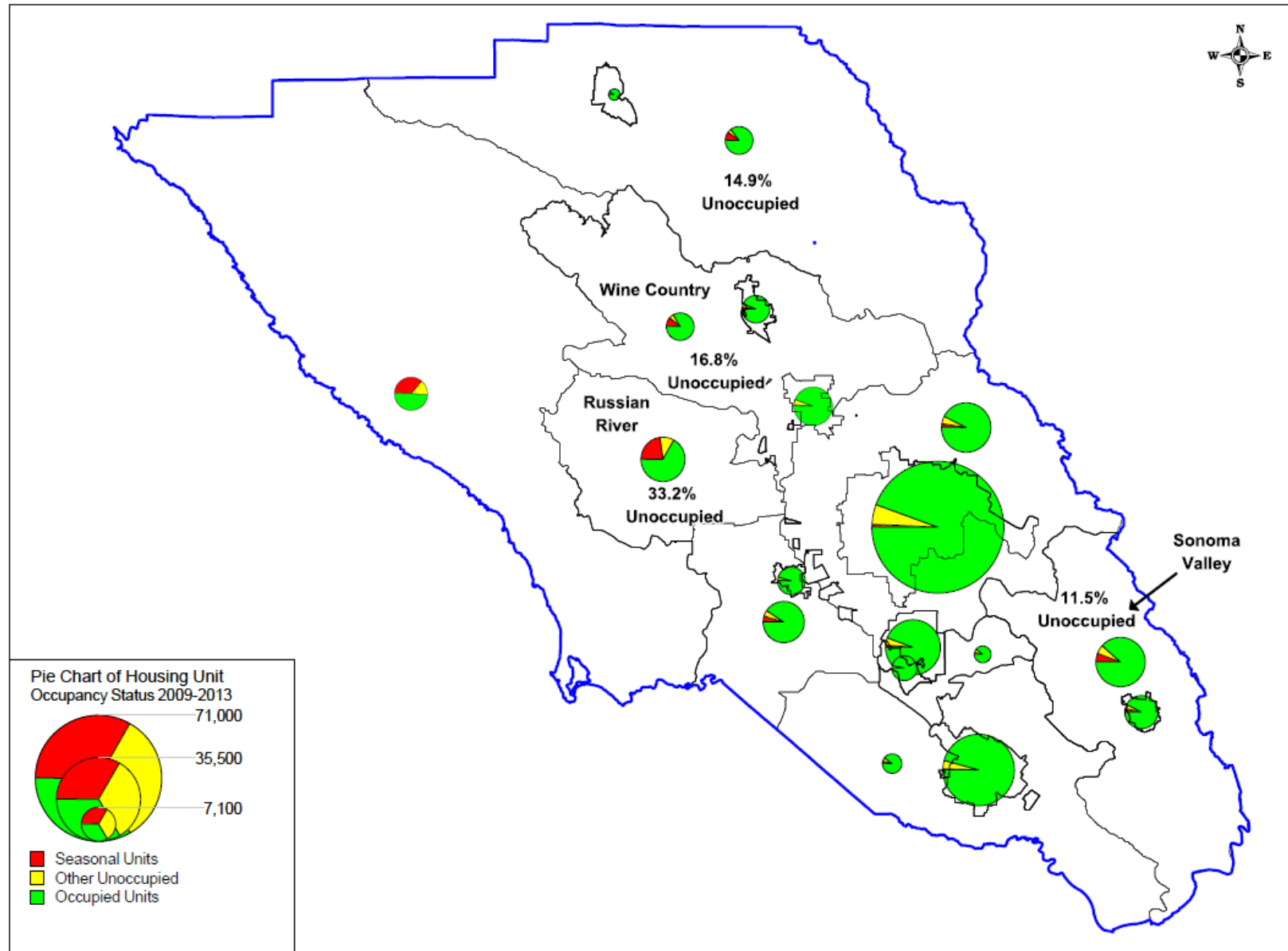


**Figure 4 ACS Trends for Sonoma County Unoccupied Units (%)**



**Figure 5** shows the proportional composition of housing supply in Sonoma County, with pie charts proportional in size to the total number of housing units by subarea, and with each pie's segments in proportion to the local percentages of seasonal units, other unoccupied units and occupied housing. A side-by-side examination of **Figure 5** with **Figure 1** shows that AirBnB whole-house listings are concentrated in those areas where the seasonal unit and other unoccupied housing rates are greatest. Where seasonal unit and overall unoccupied ratios are lowest, AirBnB room-in-house or other (not whole-house) listings tend to predominate.

**Figure 5 Unoccupied Housing Rates in Sonoma County Subareas**



## *REGULATORY AND MITIGATION STEPS*

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The impacts of the rapidly expanding vacation rental market on housing supply and neighborhood integrity in Sonoma County as documented in this Paper and in the County's related public outreach efforts suggest that mitigation (to reflect the costs of additional housing demand in the tax on the industry and also to limit and offset loss of housing units) and additional regulatory controls (to reduce the nuisance effects of vacation rentals on the resident population) are in order. Given market trends, even with additional taxation and regulatory limitations, the shift of housing previously available to the County's working families to use by visitors is expected to continue.

Focusing on the issue of shift of units from the residential rental market (recognizing that other additional controls may be in order to address other neighborhood impacts) this regulatory effort should seek to limit shifts of "whole-house" rentals, especially those located in the older residential neighborhoods proximate to the County's key visitor destinations. Since even with such controls there will remain a shift (a loss of residential rental units), further mitigation is justified through internalizing the cost of the housing losses into the price of vacation rental units.

### ***Recommendation #1 -- Prohibit vacation rentals in urban residential zones and require a discretionary permit in rural residential zones.***

As a part of its public outreach and research efforts pursuant to the direction of the Board of Supervisors, PRMD staff has identified a range of policy options.<sup>8</sup> While there is a range of issues and impacts that have been revealed by the PRMD outreach efforts for which policy options have been identified, this Paper is focused on one of these impacts, the conversion of whole-house units to vacation rentals. Such conversion of the housing stock has occurred and substantially impacted the housing market. The conversion of housing stock will continue to occur given existing market trends thus shifting more of the County's housing stock otherwise available to working families, unless action is taken to further limit the conversion.

In order to preserve housing stock for housing use, strict limitations should be placed on allowing the conversion of additional residential housing stock to visitor-serving use. The most efficient policy option identified is to prohibit further whole-house vacation rentals in the urban residential zones. In rural areas, conversion of residential housing stock could be limited through requiring a discretionary use permit process. This approach would involve the least need for ongoing analytical or enforcement efforts, and may continue to allow whole-house vacation rentals in nonresidential areas where loss of residential housing supply is not expected to be a problem.

In areas where whole-house short-term rentals are not outright prohibited, additional regulatory measures should be put into place to avoid further housing loss. For example, vacation rental uses in residential neighborhoods could be limited to "hosted" rentals where the housing unit remains in long-term residential use, but the resident is allowed to rent out a room to visitors. Another option that has merit is to limit vacation rentals to seasonal use, maintaining long-term

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<sup>8</sup> Summary of Policy Options, PRMD, May 18, 2015

residency for most of the year. This would avoid the loss of housing stock while still allowing residents to make a room or rooms available to visitors on a short-term basis.

***Recommendation #2: Allocate a portion of the County's transient occupancy taxes to provide incentives and subsidies for affordable and workforce housing.***

The growing number of vacation rentals in Sonoma County creates two impacts related to housing supply:

- First, by increasing the supply of lodging units and accommodating additional visitors in the County, vacation rentals increase economic activity and thus employment in the County's tourism business sector. This increase in employment creates demand for housing. Given that the tourist sector employment is dominated by service industries including lodging and food services its average wages, as previously cited are below \$30,000 per year, there is, and will continue to be an increased demand for affordably priced units as the industry grows.
- Second, as whole housing units are shifted from providing housing for the County's working families to providing lodging for visitors, there will be less housing supply.

As these two impacts contribute to what is a larger housing supply problem in Sonoma County, they should be mitigated as a part of the broader effort to expand housing available to the homeless and the County's growing workforce. Funding affordable housing programs with a portion of the existing (or increased) TOT or an annual fee levied on vacation rentals as part of the permitting process offers a direct and effective way of raising funding to support the County's affordable housing programs and thus mitigate losses of housing otherwise available to working families. An increase in TOT could be an added tier of 2 percent (over and above the existing 9 percent) which would be applicable only to vacation rentals or other transient uses of the housing stock. Revenue from such a TOT increase could be combined with other funding sources including the County's inclusionary housing in lieu fees, tax credits, and grant funding sources that are presently available for funding affordable and workforce housing programs.

***Recommendation #3 -- Provide targeted waiver of County development impact fees.***

As an incentive to multifamily housing production, the County's development impact fees for multifamily development projects could be "waived" until rental housing vacancy rates reach 5 percent (a "normal" market condition). The County's development impact fee revenues foregone by such a waiver can be offset (backfilled) by an appropriation of the additional tax or fee revenue levied on vacation rental units. Such a targeted development incentive, especially with improving market conditions, is likely to result in multifamily housing production, including both market rate units and those affordable units provided by the non-profit sector.

***Recommendation #4 -- Improve the development readiness of County-identified housing sites.***

The County's General Plan Housing Element has identified 136 sites (parcels) located around the County's unincorporated communities that are zoned for residential uses. Given current applied zoning regulations these sites have an estimated capacity for nearly 3,000 housing units.<sup>9</sup>

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<sup>9</sup> Sonoma County General Plan Housing Element

However, as is made quite clear by the very limited housing production activity that has occurred in recent years, even as the overall economy has recovered, these sites face site-related and institutional development constraints in addition to the aforementioned market and financing constraints.

As a means to further incentivize housing production, a County program should be created and a special fund established expressly to improve the development readiness of the County's available multifamily (or convertible to multifamily) sites and to otherwise incentivize new development. The goal of this program should be to identify and relieve development constraints on a site-by-site basis and in so doing reduce development costs and related investment risks. For example, lack of adequate infrastructure or unavailability of utility services to these sites may very well constrain development. Such costs or institutional constraints may be relatively easy for the County or its dependent special districts to relieve even with existing resources. The private sector views such constraints as additional development costs, time delays, and risks often significant enough to deter investment in new housing.

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