

bae urban economics

**INCLUSIONARY HOUSING AND IN-LIEU FEE
FINANCIAL FEASIBILITY STUDY
CITY COUNCIL STUDY SESSION**

CITY OF LOS ALTOS

December 12, 2023

PRESENTATION OVERVIEW

- Purpose of Inclusionary and In-Lieu Fee Study
- Overview of current requirements
- Overview of relevant development trends in Los Altos
- Overview of methodology
- Findings

PURPOSE OF STUDY - HEU

- **Program 2.A: Continue to implement and enhance inclusionary housing requirements.**
 - Continue to implement inclusionary housing requirements
 - Evaluate inclusionary requirements, specifically:
 - Inclusionary housing rates (e.g., 15 and 20 percent).
 - Affordability levels, with the potential for an alternative mix of affordability to meet housing policy objectives (e.g., deeper affordability, units for special needs groups)
 - Affordability terms, including requiring the longest term allowable
 - Develop strategies and amendments to support the production of affordable housing more effectively through inclusionary housing
 - Objective: Inclusionary housing unit production of at least 50 moderate-income units, 40 low-income units, and 10 very low-income units.

PURPOSE OF STUDY - HEU

- **Program 2.B: Establish an affordable housing in-lieu fee and commercial linkage fee**
 - Conduct a feasibility analysis to support the establishment of an affordable housing in-lieu fee for residential developments and a commercial linkage fee for affordable housing
 - Adopt fees based on the analysis
 - Analysis will ensure that the in-lieu fees are not a constraint to housing development
 - City will conduct outreach to all stakeholders including residents, property owners, and housing and commercial developers
 - **Time Frame: Adopt housing in-lieu fee by the end of 2023; begin commercial linkage fee for affordable housing by end of year 2025.**

PURPOSE OF STUDY

- Evaluate feasibility of new residential development
 - Inclusionary ordinance requires some units in new residential developments to be affordable
- Analyze options for in-lieu fee rates and identify fee options
 - Can provide an option for developers to pay a fee instead of building inclusionary units

CURRENT INCLUSIONARY REQUIREMENTS

Rental (10+ units)	Ownership (10+ units)	5-9 units (own or rent)
20% low-income - or - 15% very low-income	15% majority moderate-income, remaining very low-income	15% very low-, low, or moderate-income

CURRENT INCLUSIONARY REQUIREMENTS

- Study includes a summary of inclusionary requirements in 8 nearby jurisdictions for comparison purposes
- Most require **15% affordability** (in most cases)
- By comparison, Los Altos:
 - Requires either **more units** or **deeper affordability** for **rental** developments
 - Is **unique** in requiring **very low-income** for **ownership** (may encourage or facilitate use of Density Bonus)

MULTIFAMILY DEVELOPMENT TRENDS

- Recent projects have included **condos** and **townhomes**; **almost no market rate multifamily rental** development
- Current zoning designations support relatively low-density development
 - E.g., up to 38 dus/acre, height limits of 30-35 feet
- Housing Element Update commits to increasing allowable densities and height limits in some areas

MULTIFAMILY DEVELOPMENT TRENDS

- Recent projects have **exceeded base densities** using the State Density Bonus Ordinance (DBO)
 - Additional density, other waivers of development standards for projects with affordable units
 - Larger bonuses for more affordable units, deeper affordability
 - Inclusionary units count toward affordability requirements for DBO
- Projects have also sought **discretionary approvals** to exceed max **additional density** provided by the DBO

METHODOLOGY

- Financial proforma modeling to evaluate the financial feasibility of new residential development in Los Altos
- Assumptions based on developer interviews, information on recent projects, published data sources
- Evaluated multifamily rental, condominium, and townhome developments
- Based on current development standards and hypothetical increase in allowable density to 70 du/acre

RESIDENTIAL DEVELOPMENT FEASIBILITY FINDINGS

	Multifamily Rental		Multifamily Ownership		Townhouse
	Higher-Density	Current Standards	Higher-Density	Current Standards	
Density (base)	70 du/acre	38 du/acre	70 du/acre	38 du/acre	14.5 du/acre
Density (w bonus)	105 du/acre	57 du/acre	84 du/acre	57 du/acre	17.5 du/acre
Total Units	105	57	42	57	35
Affordable Units	11	6	6	10	5
Feasible?	No	No	Yes	No	Yes

RESIDENTIAL DEVELOPMENT FEASIBILITY FINDINGS (CONTINUED)

- Higher density condos & townhouses are financially feasible
- Multifamily rental & low-density condos face feasibility challenges
- Consistent with recent development trends in Los Altos and current challenges in the broader market
- Changes in City policies & market conditions necessary to produce significant quantities of new rental units

INCLUSIONARY HOUSING IN-LIEU FEE OVERVIEW

- Inclusionary in-lieu fees: option for developer to pay a fee instead of providing inclusionary units
- May be allowed only in certain situations (e.g., small projects or fractional unit req's)
- May be allowed only with discretionary approvals
- Rates influence developers' decisions regarding paying fees vs. providing units
 - Lower fees encourage developers to pay in-lieu fee
 - Higher fees encourage developers to provide units

IN-LIEU FEE POLICY CONSIDERATIONS

	In-Lieu Fees vs. Inclusionary Units
In-Lieu Fee Pros	<ul style="list-style-type: none">• Fees can be combined with other sources to create more units• May achieve deeper affordability• Fund units in 100% affordable developments, facilitating service provision
In-Lieu Fee Cons	<ul style="list-style-type: none">• Not integrated with market-rate units/less equitable• Requires site acquisition & planning of separate project, meaning increased risk and delay in affordable unit production• City burden to collect/distribute fees• Need to generate enough revenue to have a significant impact

IN-LIEU FEES IN NEARBY JURISDICTIONS

	For Sale	Rental
Cupertino	\$20-\$27/sq. ft.	\$27-34/ sq. ft
Los Gatos	6% of building permit valuation	
Menlo Park	3% of sale price for each unit for which BMR units not provided	Cost to build & maintain a unit
Mountain View	\$59-\$135/sq. ft.	\$104/sq. ft.

	For Sale	Rental
Palo Alto	\$61-\$92/sq. ft.	\$25/sq. ft.
Saratoga	N/A; no inclusionary ordinance	
Santa Clara	Difference b/t the market value and the affordable sale price	\$22/sq. ft.
Sunnyvale	7% of sale price	\$14-\$29/sq. ft.

Most jurisdictions shown allow the in-lieu fee payment option only for specific types of projects, fractional units, and/or with City Council approval

INCLUSIONARY IN-LIEU FEE APPROACH

- **Construction cost:** Cost to construct an affordable unit, less income from the unit
- **Point of indifference:** Fee rate that is equivalent in cost to providing inclusionary units
- Fees in comparison jurisdictions also provide insight

IN-LIEU FEE FINDINGS (IN-LIEU FEE PER SQ. FT.)

	Multifamily Rental		Multifamily Ownership		Townhouse
	Higher-Density	Current Standards	Higher-Density	Current Standards	
Construction Cost Approach	\$120	\$146	\$139	\$148	\$211
Point of Indifference Approach	\$32	\$28	\$74	\$74	\$19

RECOMMENDATIONS

- 1. Increase residential densities, FAR standards, and/or height limits in multifamily areas to increase the allowable residential development capacity (Completed)**
- 2. Consider additional changes to development standards and permit processing procedures, reductions in City fees to facilitate multifamily rental development **(Study Underway)****

RECOMMENDATIONS

3. Consider reducing inclusionary requirements for rental developments if Recommendations 1 and 2 are not fully implemented (**Reduction in Inclusionary Requirement by 5% across the board, or modify to affordability only at low-income threshold**)
4. Adopt in-lieu fees based on City objectives with respect to the inclusionary program and the point of indifference calculations (**Adopt appropriate inclusionary in-lieu fee based on financial feasibility**)

Higher than the point of indifference to incentivize unit production, lower to incentivize fee payment

NEXT STEPS

- Based on tonight's direction City staff will return with final recommendations in January 2024 for adoption of in-lieu fee.
- Should the City Council provide necessary direction staff will return with amendments to Inclusionary Ordinance affordability requirements.

