APPENDIX D
ECONOMIC & PLANNING SYSTEMS
BELOW MARKET RATE HOUSING POLICY ALTERNATIVES

Economic &
Planning Systems
Real Estate Economics
Regional Economics
Public Finance
Land Use Policy

DRAFT MEMORANDUM

To: Sandy Council, City of San Mateo

From: Darin Smith and Eileen Tumalad

Subject: Below Market Rate Housing Policy Alternatives; EPS #16078

Date: June 4, 2007

INTRODUCTION

The City of San Mateo (City) is conducting a review of its land use and affordable housing policies. The Below Market Rate (BMR) Housing Policy and voter initiatives, such as Measure P, currently guide the City's approaches to the provision of affordable housing. Economic & Planning Systems, Inc. (EPS) was retained by the City to evaluate the potential for improvements to the BMR Housing Policy within this regulatory context.

EPS conducted a series of market and feasibility analyses to assess the impact of various modifications to the current BMR Housing Policy. Through this analysis, meetings with the general public and the Technical Advisory Committee (TAC), as well as analysis of legal requirements and best practices in surrounding jurisdictions, a set of policy and programmatic alternatives have been developed. The goal is to increase the supply of affordable housing without having deleterious effects on the community or economic development initiatives. In addition to the feasibility analysis, EPS calculated an in-lieu fee, which developers could pay as part of meeting their BMR Housing Policy obligation.

CURRENT BELOW MARKET RATE HOUSING POLICY

The City's current BMR Housing Policy requires that no less than 10 percent of the units be affordable in developments of 11 or more units. In determining the number of affordable units required, any decimal fraction below 0.5 shall be rounded down to the nearest whole number and any decimal fraction 0.5 or above shall be rounded up to the nearest whole number. For-sale affordable units shall be affordable to moderate income households at 120 percent of area median income (AMI), while rental affordable units shall be affordable to lower income households at 80 percent of AMI. The affordable units must be dispersed throughout the project and the number of bedrooms in affordable units must be provided at the same ratio as the market rate units. Affordable ownership units require a 45-year affordability agreement. Off-site construction is allowed only if on-site construction is infeasible and construction of the off-site units is completed at the same time or sooner than the market rate units.

MEASURE P

Measure P is an initiative approved by the voters in 2004. Measure P details policies on building heights, residential densities, commercial and office square footage, and affordable housing. The voter-approved policies outlined in Measure P limit the alternatives available to amend the current BMR Housing Policy. According to Measure P, no fees are allowed in-lieu of the construction of the affordable units. However, Measure P does allow in-lieu fees for developments of 10 units or less or for fractional affordable housing requirements of less than 0.5. Measure P also requires that affordable units be similar in exterior design and appearance to the market rate units in the project.

COMPARATIVE ANALYSIS

In order to determine how the City's requirements compared to other jurisdictions, EPS surveyed all the jurisdictions in San Mateo County to determine if they had an inclusionary housing policy and if so, what the details of the policy are. **Tables 1** and **2** summarize the results of the survey. Of the 21 jurisdictions in the County, 12 have an inclusionary housing policy. The requirements ranged from 10 percent to 20 percent, with a majority of the jurisdictions having a requirement greater than 10 percent. Nine of the 12 jurisdictions allow a fee to be paid in-lieu of the construction of affordable units. Nine of the 12 jurisdictions provide the option for developers to construct the affordable units off-site.

THE ECONOMICS OF AFFORDABLE HOUSING

Requiring affordable housing units to be incorporated into otherwise market-rate projects typically has a negative affect on the projects' feasibility. By restricting the achievable prices for affordable housing units to rates below what the market would otherwise bear, the developer receives less money for the affordable units while the costs to produce those units stays constant. Unless those reduced revenues are offset by reductions in development costs or other enhancements to the project's cashflow, a project with inclusionary housing units faces feasibility challenges beyond those faced by purely market-rate development. The larger the affordable housing requirement, the larger the feasibility challenge faced.

For example, it should be obvious that a project that provides 10 percent affordable units for moderate incomes (120 percent of AMI) will generate larger revenues than a project that provides 10 percent affordable units for lower incomes (80 percent of AMI) or 20 percent moderate income units. Less obviously, a project that requires 20 percent moderate income units may in fact be more feasible than a project requiring 10 percent low income units, because the implicit subsidies for the low income units may be more than twice those for the moderate income units. This dynamic depends on the costs of construction for the type of unit being developed (which can vary substantially depending on construction type, size, and parking solution), as well as the prices allowable for the income-restricted units.

THE COST BURDEN

In theory, the costs associated with the development of affordable housing can be borne by land owners, developers, and/or future homeowners. The cost burden is often determined by different factors, such as flexibility of land costs or the type of project. **Figure 1** summarizes these effects.

In practice, developers rarely bear the costs associated with affordable housing. A developer or investor always chooses among potential projects or investments, given the expected financial returns on their investment and the level of risk involved in the venture. A for-profit developer or investor is highly unlikely to accept a reduction in their return on investment if alternative investments could yield higher or equal returns with equal or less risk. Thus, developers will not construct the project unless their desired rates of return are achievable.

Where land costs are flexible—for instance, on parcels that have no existing income-producing uses—the land owners typically bear the additional cost associated with affordable housing. Construction costs and achievable prices for market-rate development tend to be fixed and developers require a certain level of profit, so a reduction in achievable revenues associated with the affordable units is translated into a lower payment for the acquisition of the land for development. Landowners whose properties are subject to inclusionary housing requirements therefore do achieve lower values for their land than those without such requirements, all else being equal.

If land costs are fixed, as can be the case with in-fill development or redevelopment where the land owners require a certain land price that exceeds the value of an existing use, then future homeowners tend to bear the cost of affordable housing. To achieve their desired returns after paying a fixed land price and construction costs, developers must be able to charge a price for the market-rate units that offsets the subsidies required for the inclusionary units. Thus, the average market-rate home price will be higher than it otherwise might be in a purely market-rate project.

Of course, this assumes that developers are charging only as much for market-rate units as is required to achieve their financial return goals. In reality, developers typically charge as much as the market will bear for market-rate units, irrespective of the "minimum" return thresholds they seek. If developers do not believe they can achieve the market-rate prices required to offset the affordable housing costs, the project simply will not be developed. Thus, the true effect is likely to be realized through reduced development overall that restricts housing supply and causes greater competition for the finite number of homes available.

MITIGATING THE AFFORDABLE HOUSING COSTS

There are a number of ways to mitigate the costs associated with providing affordable housing. The State of California allows for a density bonus to be granted to developers who include affordable housing in their projects. Local agencies can also help through direct subsidies and/or fee waivers, or by allowing developers to meet their obligations through more cost-effective means. These efforts reduce the costs of development as a way to offset the decrease in revenues resulting from the inclusion of affordable housing.

Density Bonus

As a way to mitigate the costs associated with the provision of affordable housing, the State provides incentives to developers who include affordable housing in their projects. It requires jurisdictions to grant developers density bonuses of 5 to 35 percent above current density limits, depending on the amount and type of affordable housing provided. The rationale for the density bonus is that it can help to enhance project feasibility by increasing revenues from additional market rate units. **Figure 2** summarizes the details of the State Density Bonus law.

Figure 2: State Density Bonus Law

Affordability Target	Minimum % of Units Required	Bonus Granted	Additional Bonus for Each 1% Increase in Units	% of Units Required for Maximum 35% Bonus
Very-Low Income (50% AMI)	5%	20%	2.5%	11%
Lower-Income (80% AMI)	10%	20%	1.5%	20%
Moderate Income (120% AMI)	10%	5%	1%	40%

The State Density Bonus is separate from the City's BMR Housing Policy. In fact, the current BMR Housing Policy triggers a density bonus of 5 percent for ownership units and 20 percent for rental units.

EPS tested five density bonus scenarios. The analysis shows that a density bonus can help enhance the feasibility of development by increasing revenues from added market rate units, but only up to a certain threshold. Maximizing the density bonus, 35 percent additional units, often has a negative effect on feasibility because of the increased subsidies required for the affordable units. A summary of the results is shown in **Figure 3**.

Cost-Effective Approaches

Some jurisdictions require that all inclusionary units must be essentially the same as the market-rate units in a project, in terms of size, design, tenure, and other important attributes. For a luxury residential development, this requirement might require that homes that could be sold at market rates exceeding $1 million must in fact be sold for less than half that price. The families that are fortunate enough to be placed in such units receive an extraordinary benefit from such policies.

Other jurisdictions allow certain levels of flexibility in terms of the characteristics of inclusionary units. For example, the sizes of affordable units may be smaller than the market-rate units (within certain parameters) or the level of architectural finish in the units may be lower. Some jurisdictions also allow multifamily rental housing units to be built to satisfy the inclusionary requirements of an otherwise for-sale, single-family project, and/or allow the affordable units to be built off site.

Such approaches provide flexibility for the developers to find their own most cost-effective means of meeting their affordable housing obligation. In some circumstances, the flexibility allowances are prescribed, and in others they are at the discretion of local policymakers, who can determine if the developers' proposed approach meets a pressing housing demand and fulfills the same or greater obligation they otherwise would have.

POLICY ALTERNATIVES

City staff has developed a number of BMR Housing Policy alternatives, which was informed by the public, the TAC, and EPS. As part of the effort to develop a set of BMR Housing Policy alternatives, EPS conducted a series of feasibility analyses for four prototypical product types provided by City staff. The four prototypes represent the type of units typically seen in developments in the City. They are as follows:

- 2-3 Stories Townhome with Garages
- 2-3 Stories Over At Grade Podium Parking
- 3-4 Stories Over Underground Parking
- 6 Stories Over Underground Parking

In order to develop cost and revenue estimates, a set of assumptions was developed for each prototype. A comparison of development costs and revenues for various policy alternatives were used to determine potential feasibility and development impacts. The potential feasibility and development impacts are summarized in **Appendix A**. City staff then determined which policy alternatives would likely result in more affordable housing within the City's regulatory framework, while minimizing any potential negative effects on community or economic development initiatives.

INCREASE BMR REQUIREMENT

15 Percent Requirement

As determined in the comparative analysis, a majority of jurisdictions with an inclusionary housing policy have requirements greater than 10 percent. With a current requirement of 10 percent, the City falls on the lower end of the spectrum. City staff has suggested increasing the BMR requirement to 15 percent. Increasing the BMR requirement to 15 percent without any offsetting reductions in cost or enhancements to values would reduce project feasibility, but not halt development as other jurisdictions in San Mateo County and elsewhere in California with requirements of 15 percent or more continue to develop residential units.

City staff has also suggested increasing the BMR requirement to 15 percent, while also providing developers with flexibility in meeting the higher requirement. In accordance with Measure P and the current BMR Housing Policy, the first 10 percent is required to be constructed on site while the remaining 5 percent requirement can be met with off-site construction or the payment of an in-lieu fee. Both alternatives provide developers with flexibility in meeting the increased requirement, which allows them to determine the method that is most efficient. Allowing flexibility is a way to minimize the negative feasibility impacts of the increased BMR requirement.

EPS compared the growth rates in residential units over the past five years in jurisdictions with various inclusionary housing requirements to the County's growth rate to determine whether higher requirements negatively affect residential development. There does not appear to be a systematic relationship between the residential unit growth rate and the inclusionary requirement. Jurisdictions with the highest requirement, 20 percent, experienced growth rates higher than the County in 2001, 2003, and 2004, but lower growth rates than the County in 2002 and 2005. Overall, jurisdictions with the lowest inclusionary requirement of 10 percent tend to have a lower growth rate than the County. This evaluation suggests that local factors (market support, land availability, growth restrictions, etc.) appear to impact housing production more than inclusionary requirements. **Figure 4** summarizes the results of the comparison of residential unit growth rates.

Tiered BMR Requirement

As an alternative to increasing the requirement for all developments, City staff has suggested a tiered system that increases the affordability requirement as the number of units in a project increase. The requirement will start at 10 percent, increase to 12 percent as the project increases, and the maximum would be 15 percent. The rationale for a tiered requirement is that larger projects can afford to have more affordable units than smaller projects because larger projects have lower per unit construction costs resulting from economies of scale. The impacts of a tiered requirement will depend on how large of a reduction in costs results from the economies of scale enjoyed by larger projects. The feasibility analysis suggests that project feasibility can be maintained if the increased subsidies associated with the higher requirement are offset by the decreased costs of construction resulting from economies of scale. However, it is also true that for very large projects that require new streets and other infrastructure, such costs may offset the economies of scale on building construction, and thus the tiered requirement may represent a feasibility challenge to such projects.

AFFORDABILITY TARGETS

Under the current BMR Housing Policy, rental BMR units are required to be affordable for lower income households (at 80 percent of AMI). However, very low-income households (up to 50 percent of AMI) have the largest need for rental units according to City staff. As a result, City staff suggests that instead of increasing the rental BMR requirement to 15 percent, the requirement can remain at 10 percent if the affordability target is decreased from lower incomes to very-low incomes. This effectively reduces the maximum affordable rents and thereby reduces the revenue per unit. If development costs remain the same while revenues decrease, providing rental units for very low-incomes slightly reduces project feasibility. The reduction in project feasibility was found to be very similar to increasing the requirement to 15 percent while holding the affordability targets constant.

FRACTIONAL FEES

At the current 10 percent inclusionary requirement, a 24-unit project would be mathematically responsible for 2.4 affordable units, but would be required to build only 2.0 affordable units, with the remaining 0.4 units unaccounted for because of rounding. Currently the City does not require that fees be paid for fractional affordable unit requirements. Pursuant to the BMR Housing Policy, fractional affordable units of 0.1 to 0.4 are rounded down to the nearest whole number while fractional affordable units of 0.5 to 0.9 are rounded up to the nearest whole number. An unintended consequence of this provision is that developers adjust the number of units in a project so as not to trigger the requirement of an additional affordable unit. This often means choosing not to develop to the maximum density allowed.

As a result, City staff recommends, in accordance with Measure P, that a fractional fee be required for 0.1 to 0.4 affordable units. A fractional fee will help curb the gaming of the number of units in a project so as not to trigger the requirement of an additional affordable unit. The fractional fee may enhance the feasibility of a project if the additional revenues from maximizing the number of market rate units in a project are greater than the additional fractional fees required.

City staff also suggests that fractional fees be required for projects of 4 to 10 units, which would effectively reduce the applicable project size from 11 units to 4 units. This will reduce project feasibility, but not likely stop the development of residential units. There are jurisdictions with affordable housing requirements for projects of at least four units, such as South San Francisco and Burlingame. These jurisdictions continue to have residential development. For each type of development, EPS has estimated the subsidy required for a single unit, given development costs (land, construction, fees, etc.) and the restricted values of affordable units. **Table 3** summarizes the potential fractional fees for various product types and tenures (rental vs. for-sale). The City could choose to implement fractional fees in this product-specific manner, or could calculate am average fee that could apply to all projects.

OFF-SITE CONSTRUCTION

Under the current BMR Housing Policy and Measure P, the off-site construction of affordable units is only allowed if it is demonstrated that on-site construction is infeasible. The City recommends two alternatives for off-site construction. One alternative is a land dedication where land would be set-aside for another entity, such as a nonprofit organization, to construct the affordable units. The land dedication option is a provision of the State's Density Bonus law. The other alternative is to allow the developer to determine on-site feasibility, but increase the off-site construction requirement to 20 percent. The developer would still be required to construct the affordable units.

Land Dedication

A land dedication, as detailed in the State's Density Bonus law, would only be allowed if the parcel is large enough to accommodate at least 10 percent of the market rate units at densities suitable for very-low income units. The land must also be at least one acre is size or large enough to accommodate at least 40 units. It must be served by adequate public facilities and infrastructure and have all the necessary approvals required to develop the affordable units. The land is then transferred to a local agency or developer who will construct the affordable housing. Land dedication may be less expensive for developers than the construction of affordable units, therefore allowing for land dedication as a way to meet the BMR Housing Policy obligations can increase project feasibility. Moreover, this approach could engage nonprofit builders who are more experienced in constructing and managing affordable units and whose access to external funding sources may allow the affordable units to be priced for lower income levels or meet other special needs.

Increased Requirement

Currently off-site construction is only possible if on-site construction is determined to be infeasible, but there is no definition of infeasibility. City staff has suggested that the developer could determine whether on-site construction is infeasible, but the off-site construction would require 20 percent affordable units as opposed to 10 percent. Clearly, developers would only select this option if providing 20 percent off-site proved more feasible than providing 10 percent on-site, in which case the City benefits by adding twice as many affordable units as they would otherwise receive.

FLEXIBILITY IN BMR UNIT DESIGN

Flexibility in the design of affordable units is allowed under Measure P as long as the affordable units are similar in exterior design and appearance to the market rate units in the project. City staff has recommended a number of flexibility allowances, such as allowing smaller sized affordable units as long as the bedroom count is proportional to the market rate units or, if there is a local need, allowing a different bedroom size distribution as long as the total number of bedrooms is provided. Flexibility in meeting the BMR Housing Policy obligation increases project feasibility, as developers are allowed to determine what works best for the development. This increases the efficiency of constructing both market rate and affordable residential units. The enhanced project feasibility from flexibility in BMR unit design could also allow for a higher percentage of overall units to be affordable, as also suggested by City staff.

Table 1
Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

Jurisdiction	Option	% Affordable: Total	Very Low 30-50% AMI	Low 50-80% AMI	Moderate 80-120% AMI	Workforce 120%+ AMI	Exemptions	Affordable Unit Attributes: Unit Mix	Unit size	Tenure
Atherton	No policy									
Belmont	No policy									
Brisbane [1]	Inclusionary, no ordinance	15%	5%	10%						
Burlingame	Inclusionary, 4-12 units	1 unit					Projects < 4 units	Same as market rate	Studio > 500 sq. ft., 1 BR > 650 sq. ft., 2 BR > 800 sq. ft.	Same as market rate
	Inclusionary, 13+ units	10%					Projects < 4 units	Same as market rate	Studio > 500 sq. ft., 1 BR > 650 sq. ft., 2 BR > 800 sq. ft.	Same as market rate
Colma	Inclusionary	20%	8%[2]	4%[3]			Projects < 5 units or reconstruction of any unit or development projects destroyed by fire or natural catastrophe.	Same as market rate	Same as market rate	Same as market rate
Daly City	No policy									

Table 1
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Jurisdiction	Option	% Affordable: Total	Very Low 30-50% AMI	Low 50-80% AMI	Moderate 80-120% AMI	Workforce 120%+ AMI	Exemptions	Affordable Unit Attributes: Unit Mix	Unit size	Tenure
East Palo Alto	Inclusionary, Multifamily housing	20%	5% at < 35% AMI, 10% at < 50% AMI	5% at < 60% AMI				Same as market rate	Same as market rate	Can substitute rental instead of for-sale units, but they must be comparable in size and amenities to for-sale units. If not, then the deficiency will be compensated for with additional units for lower income households.
	Inclusionary, single-family detached housing	20%		5% at < 60% AMI, 10% at < 80% AMI	5% at < 90% AMI			Same as market rate	Same as market rate	Can substitute rental instead of for-sale units, but they must be comparable in size and amenities to for-sale units. If not, then the deficiency will be compensated for with additional units for lower income households.
	Inclusionary, single-family attached housing	20%	5% at < 50% AMI	10% at < 60% AMI, 5% at < 70 % AMI				Same as market rate	Same as market rate	Can substitute rental instead of for-sale units, but they must be comparable in size and amenities to for-sale units. If not, then the deficiency will be compensated for with additional units for lower income households.
Foster City	Inclusionary	20%					Projects < 10 units	Same as market rate	Same as market rate	
Half Moon Bay	Inclusionary	20%	6%	7%	7%		Projects < 10 units			
Hillsborough	No policy									

Table 1
Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

		% Affordable						Affordable Unit Attributes		
Jurisdiction	**Option**	**Total**	**Very Low** 30-50% AMI	**Low** 50-80% AMI	**Moderate** 80-120% AMI	**Workforce** 120%+ AMI	**Exemptions**	Unit Mix	Unit size	Tenure
Menlo Park	Inclusionary, residential 5-9 units	1 unit			1 unit at < 110% AMI		Projects < 5 units	Same as market rate	Same as market rate	
	Inclusionary, residential 10-19 units	10%		Rental units in redevelopment area: 10% at <60% AMI, Rental units everywhere else: 10% at < 80%	For sale units: 10% at < 110% AMI		Projects < 5 units	Same as market rate	Same as market rate	
	Inclusionary, residential 20+ units	15%		Rental units in redevelopment area: 15% at < 60% AMI, Rental units everywhere else: 15% at < 80%	For sale units: 15% at < 110% AMI		Projects < 5 units	Same as market rate	Same as market rate	
Millbrae	No policy									
Pacifica	Inclusionary	15%	6%	4.5%	4.5%		Projects < 8 units	Same as market rate	Generally of comparable same to market rate units, but may be reduced if project is in a very of high density zone.	
Portola Valley	Inclusionary	15%								
Redwood City	No policy									
San Bruno [1]	Inclusionary, no ordinance	15%		6% shared between very-low and low income	9%		Projects < 10 units	Same as market rate	Same as market rate	Same as market rate

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San Mateo Housing, EPS# 16078

		% Affordable						Affordable Unit Attributes		
Jurisdiction	**Option**	**Total**	**Very Low** 30-50% AMI	**Low** 50-80% AMI	**Moderate** 80-120% AMI	**Workforce** 120%+ AMI	**Exemptions**	Unit Mix	Unit size	Tenure
San Carlos	Inclusionary	15%	7%	7%	1%		Projects > 7 units, residential development of a legal second dwelling unit, residential remodels that don't increase total floor area, or single-family residential additions increasing floor area by < 25%	Same as market rate	Same as market rate	Same as market rate
San Mateo	Inclusionary, ownership units	10%			10%		Projects < 11 units	Same as market rate	Studio > 460 sq. ft., 1 BR > 550 sq. ft., 2 BR > 800 sq. ft., 3 BR > 1080 sq. ft.	Same as market rate
	Inclusionary, rental units	10%		10%			Projects < 11 units	Same as market rate	Studio > 460 sq. ft., 1 BR > 550 sq. ft., 2 BR > 800 sq. ft., 3 BR > 1080 sq. ft.	Same as market rate
San Mateo County	Inclusionary, ownership units	20%		10%	10%		Projects < 5	Same as market rate	Same as market rate	
	Inclusionary, rental units	20%	10%	10%			Projects < 5	Same as market rate	Same as market rate	
South San Francisco	Inclusionary	20%		8% total, one-third at < 60%, one-third at < 70%, one-third at < 80%	12% total, one-third at < 90%, one-third at < 100%, one-third at < 110%		Projects < 4 units	A mix based on the City's affordable housing demand priorities	A mix based on the City's affordable housing demand priorities	Same as market rate
Woodside	No policy									

Source: Respective City and County Planning Departments

Notes:
[1] These jurisdictions are currently in the process of developing an inclusionary housing ordinance.
[2,3] The income targets of the remaining 8% of the affordable units is at the developer's discretion.

Table 2
Alternatives Included in the Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

Jurisdiction	**Option**	**In-lieu Fee** Application	**In-lieu Fee** Amount	**Off-Site Option**	**Resale Restrictions**	**Incentives**
Atherton	No policy					
Belmont	No policy					
Brisbane [1]	Inclusionary, no ordinance	No in lieu fee can be paid		None	Affordable in perpetuity.	
Burlingame	Inclusionary, 4-12 units	No in lieu fee can be paid		None	Initial sales price increased or decreased at the same rate as median income. 10 year affordability agreement or can enter in to 30 year agreement.	May use two of the following: (1) height >= 46 ft without a conditional use permit, (2) reduction of rear common space of up to 50% or 200 sq. ft, whichever is more, without necessity of a variance, (3) If more than 10 on-site parking spaces required, allowance of up to 50% of the required parking as compact stalls without necessity of variance. Additional reduction in parking requirement if developers enter in to 30 year affordability agreement.
	Inclusionary, 13+ units	No in lieu fee can be paid		None	Initial sales price increased or decreased at the same rate as median income. 10 year affordability agreement or can enter in to 30 year agreement.	May use two of the following: (1) height >= 46 ft without a conditional use permit, (2) reduction of rear common space of up to 50% or 200 sq. ft, whichever is more, without necessity of a variance, (3) If more than 10 on-site parking spaces required, allowance of up to 50% of the required parking as compact stalls without necessity of variance. Additional reduction in parking requirement if developers enter in to 30 year affordability agreement.
Colma	Inclusionary	Pay for fractional units or projects with < 12 units	Difference between the amount received from sale or rental of BMR unit and the cost of its construction.	If the need for BMR housing is greater in the off-site location than in the area of the proposed development.	Lowest of following amounts: (1) fair market value, (2) seller's purchase price increased by the lessor of the rate of increase of AMI for the duration of ownership or the rate at which the CPI increased during the seller's ownership. 45 year affordability agreement.	Parking reduction, expedited review process, and fee reductions

Table 2
Alternatives Included in the Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

Jurisdiction	Option	In-lieu Fee: Application	In-lieu Fee: Amount	Off-Site Option	Resale Restrictions	Incentives
Daly City	No policy					
East Palo Alto	Inclusionary, multi-family housing	Projects with four or fewer units	Per square foot fee, established by the Master Fee Schedule, applied to the aggregate building area of all the market-rate homes. If fee has not been adopted, fee will be $10.60/sq. ft.	None	Lowest of the following amounts: (1) maximum permitted affordable housing cost for household of the maximum income level permitted at initial sale, (2) seller's purchase price increased at one-third the rate of increase in CPI for duration of ownership, (3) fair market value, (4) seller's purchase price plus reasonable cost of sales and value of capital improvements	
	Inclusionary, single-family detached housing	Projects with four or fewer units	Per square foot fee, established by the Master Fee Schedule, applied to the aggregate building area of all the market-rate homes. If fee has not been adopted, fee will be $10.60/sq. ft.	None	Lowest of the following amounts: (1) maximum permitted affordable housing cost for household of the maximum income level permitted at initial sale, (2) seller's purchase price increased at one-third the rate of increase in CPI for duration of ownership, (3) fair market value, (4) seller's purchase price plus reasonable cost of sales and value of capital improvements	
	Inclusionary, single-family attached housing	Projects with four or fewer units	Per square foot fee, established by the Master Fee Schedule, applied to the aggregate building area of all the market-rate homes. If fee has not been adopted, fee will be $10.60/sq. ft.	None	Lowest of the following amounts: (1) maximum permitted affordable housing cost for household of the maximum income level permitted at initial sale, (2) seller's purchase price increased at one-third the rate of increase in CPI for duration of ownership, (3) fair market value, (4) seller's purchase price plus reasonable cost of sales and value of capital improvements	
Foster City	Inclusionary	No in lieu fee can be paid		Only if developer can prove on-site affordable units are infeasible.	The City has first right of refusal, upon the sale of the unit and 35 year affordability agreement.	Rent subsidies, density bonus, expedited permit processing, design flexibility, fee reduction, assistance in securing public financing, and flexible parking standards.
Half Moon Bay	Inclusionary	Pay fee on fractional units or if developer can prove that constructing affordable units is infeasible.		Only if developer can prove on-site affordable units are infeasible.	Can be resold at any time on the open market to a qualified buyer. Deed restrictions recorded against the property.	

Table 2
Alternatives Included in the Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

		In-lieu Fee				
Jurisdiction	**Option**	Application	Amount	**Off-Site Option**	**Resale Restrictions**	**Incentives**
Hillsborough	No policy					
Menlo Park	Inclusionary, residential 5-9 units	Only if developer can prove that constructing affordable units is infeasible	Units 1, 2, and 3: 1% of sales price; Units 4, 5, and 6: 2% of sales price; Units 7, 8, 9: 3% of sales price	If authorized by the City. Can be new or existing units and must be provided on or before completion of proposed development.	Lesser of appraised market value or City established price based on original sale price, depreciated value of substantial improvements, and one-third of the increase in the cost of living index for the Bay Area.	Density Bonus < 15%
	Inclusionary, residential 10-19 units	Only if developer can prove that constructing affordable units is infeasible	3% of the actual sales price of each unit sold	If authorized by the City. Can be new or existing units and must be provided on or before completion of proposed development.	Lesser of appraised market value or City established price based on original sale price, depreciated value of substantial improvements, and one-third of the increase in the cost of living index for the Bay Area.	Density Bonus < 15%
	Inclusionary, residential 20+ units	Only if developer can prove that constructing affordable units is infeasible	3% of the actual sales price of each unit sold	If authorized by the City. Can be new or existing units and must be provided on or before completion of proposed development.	Lesser of appraised market value or City established price based on original sale price, depreciated value of substantial improvements, and one-third of the increase in the cost of living index for the Bay Area.	Density Bonus < 15%
Millbrae	No policy					
Pacifica	Inclusionary	May opt to pay an in-lieu fee for development not located in the Redevelopment Area	Depends on the cost of producing the affordable units	Only if developer can prove on-site affordable units are infeasible. Developer may also propose to dedicate land to the City for the development of BMR units, provided that the land have equal or greater development potential.	Resale value is the lesser of (1) original purchase price, plus the percentage increase in AMI from the date of original purchase, plus cost of any capital improvements, minus costs necessary to meet City Building Regulations or (2) fair market value. For-sale BMR units shall remain affordable for 45 years. Rental BMR units shall remain affordable for 55 years.	
Portola Valley	Inclusionary	Pay fee on fractional units.		If authorized by the City.	None	Density Bonus < 10%
Redwood City	No policy					
San Bruno [1]	Inclusionary, no ordinance	May opt to pay an in-lieu fee	Depends on the cost of producing the affordable units	May opt to develop affordable units off-site	55 year affordability agreement	

Table 2
Alternatives Included in the Inclusionary Housing Policies: San Mateo County
San Mateo Housing, EPS# 16078

Jurisdiction	Option	In-lieu Fee: Application	In-lieu Fee: Amount	Off-Site Option	Resale Restrictions	Incentives
San Carlos	Inclusionary	Pay fee on fractional units.	One percent of the valuation for the development of one unit. For 2-6 units, or the development of units that trigger a decimal fraction less than one-half, the fee is based on 2 percent of the valuation of the portion of the units that trigger the decimal fraction of less than one-half.	Possible if off-site construction results in 10% more BMR units than required or if there is more need for affordable housing in off-site location	Remains affordable for the useful life of the buildings.	Density bonus, modified development standard calculations, flexible parking standards, permit streamlining, and financial assistance
San Mateo	Inclusionary, ownership units	No in lieu fee can be paid		Only if on-site affordable units are determined to be infeasible.	Resale only to eligible moderate or lower-income households. 45 year affordability agreement to be reapplied and recorded upon each resale	Density Bonus
	Inclusionary, rental units	No in lieu fee can be paid		Only if on-site affordable units are determined to be infeasible.	Resale only to eligible moderate or lower-income households. 45 year affordability agreement to be reapplied and recorded upon each resale	Density Bonus
San Mateo County	Inclusionary, ownership units	Projects between 5 - 9 units	A percentage of the estimated cost to construct all the inclusionary units that would otherwise be required.	A developer developing more than one project can transfer the obligation from one site to another if the transferred units target the same goals that they would have had to meet if they were built on-site.	Resale price determined by either the original purchase price plus the percentage increase defined in the original deed or fair market value, whichever is less. 55 year affordability agreement.	Fee reduction or deferral, priority processing, and density bonus
	Inclusionary, rental units	Projects between 5 - 9 units	A percentage of the estimated cost to construct all the inclusionary units that would otherwise be required.	A developer developing more than one project can transfer the obligation from one site to another if the transferred units target the same goals that they would have had to meet if they were built on-site.	Resale price determined by either the original purchase price plus the percentage increase defined in the original deed or fair market value, whichever is less. 55 year affordability agreement.	Fee reduction or deferral, priority processing, and density bonus
South San Francisco	Inclusionary	Projects between 4 - 9 units	Developer's fractional costs of constructing a market rate unit in the project, including land and improvements	Only if doing so would better serve the City's housing element as determined by the city council	Initial sales price increased or decreased at the same rate as median income for the duration of ownership. 55 year affordability agreement.	
Woodside	No policy					

Source: Respective City and County Planning Departments

Notes:
[1] These jurisdictions are currently in the process of developing an inclusionary housing ordinance.

Table 3
Financing Gap Analysis
San Mateo Inclusionary Housing, EPS #16078

	2-3 Stories Townhome w/Garages		2-3 Stories Over At Grade Podium Parking		3-4 Stories Over Underground Parking		6 Stories Over Underground Parking	
	For-Sale	**Rental**	**For-Sale**	**Rental**	**For-Sale**	**Rental**	**For-Sale**	**Rental**
Development Program Assumptions								
Density/Acre	25	25	35	35	50	50	60	60
Average Gross Unit Size	1,800	1,800	1,400	1,400	1,400	1,400	1,400	1,400
Average Net Unit Size	1,400	1,400	1,100	1,100	1,100	1,100	1,100	1,100
Average Number of Bedrooms	3	3	2	2	2	2	2	2
Average Number of Units per Project	13	13	30	30	30	30	60	60
Parking Spaces/Unit	incl. in gross unit size	incl. in gross unit size	2	2	2	2	2	2
Building Values								
Maximum Allowable Price [1]	$304,000	$1,430	271,000	1,280	271,000	1,280	271,000	1,280
Operating Expenses as % of Gross Revenues	N/A	30%	N/A	30%	N/A	30%	N/A	30%
Net Operating Income	N/A	$12,012	N/A	$10,752	N/A	$10,752	N/A	$10,752
Capitalization Rate	N/A	6.5%	N/A	6.5%	N/A	6.5%	N/A	6.5%
BMR Value/Unit	***$304,000***	***$184,800***	***$271,000***	***$165,415***	***$271,000***	***$165,415***	***$271,000***	***$165,415***
Cost Assumptions								
Land/SF [1]	$108	$108	$108	$108	$108	$108	$108	$108
Land/Unit	$188,517	$188,517	$134,655	$134,655	$94,259	$94,259	$78,549	$78,549
Direct Costs								
Direct Construction Costs/Gross SF [2]	$185	$167	$200	$180	$200	$180	$220	$198
Direct Construction Costs/Unit	$333,000	$299,700	$280,000	$252,000	$280,000	$252,000	$308,000	$277,200
Parking Construction Costs/Space	N/A	N/A	$18,000	$18,000	$30,000	$30,000	$30,000	$30,000
Parking Construction Costs/Unit	N/A	N/A	$36,000	$36,000	$60,000	$60,000	$60,000	$60,000
Subtotal, Direct Costs/Unit	$333,000	$299,700	$316,000	$288,000	$340,000	$312,000	$368,000	$337,200
Indirect Costs as a % of Direct Costs [3]	35%	35%	40%	35%	40%	35%	40%	35%
Indirect Costs/Unit	$116,550	$104,895	$126,400	$100,800	$136,000	$109,200	$147,200	$118,020
Developer Profit Margin (% of all costs)	18%	N/A	18%	N/A	18%	N/A	18%	N/A
Developer Profit	$80,919		$79,632		$85,680		$92,736	
Total Cost/Unit	***$718,986***	***$593,112***	***$656,687***	***$523,455***	***$655,939***	***$515,459***	***$686,485***	***$533,769***
Financing Gap	**$414,986**	**$408,312**	**$385,687**	**$358,040**	**$384,939**	**$350,043**	**$415,485**	**$368,353**
In-Lieu Fee for Fractional Units [4]								
0.1 Units Required	$41,499	$40,831	$38,569	$35,804	$38,494	$35,004	$41,548	$36,835
0.2 Units Required	$82,997	$81,662	$77,137	$71,608	$76,988	$70,009	$83,097	$73,671
0.3 Units Required	$124,496	$122,494	$115,706	$107,412	$115,482	$105,013	$124,645	$110,506
0.4 Units Required	$165,994	$163,325	$154,275	$143,216	$153,975	$140,017	$166,194	$147,341

[1] For-sale value is weighted average of townhome/condominium listings for units less than 1,700 SF on www.ziprealty.com, 9/25/06. Rental value is weighted average of 3 BR units for townhomes and 2 BR units for all other prototypes from www.rent.com, 9/22/06.
[2] Assumes Direct Construction Costs for rentals are 10% less than for-sale developments
[3] Includes costs for architecture and engineering; entitlement and fees; project management, marketing, commissions, and general administration; financing and charges; insurance; and contingency
[4] In accordance with Measure P and the BMR Housing Program, in-lieu fees are allowed for fractional affordable housing unit requirement less than 0.5. Fractional affordable housing unit requirements of 0.5 or above shall be rounded up to the nearest whole number.

Figure 1
Inclusionary Housing Policy
Average Market Unit Price: Burden of Incidence

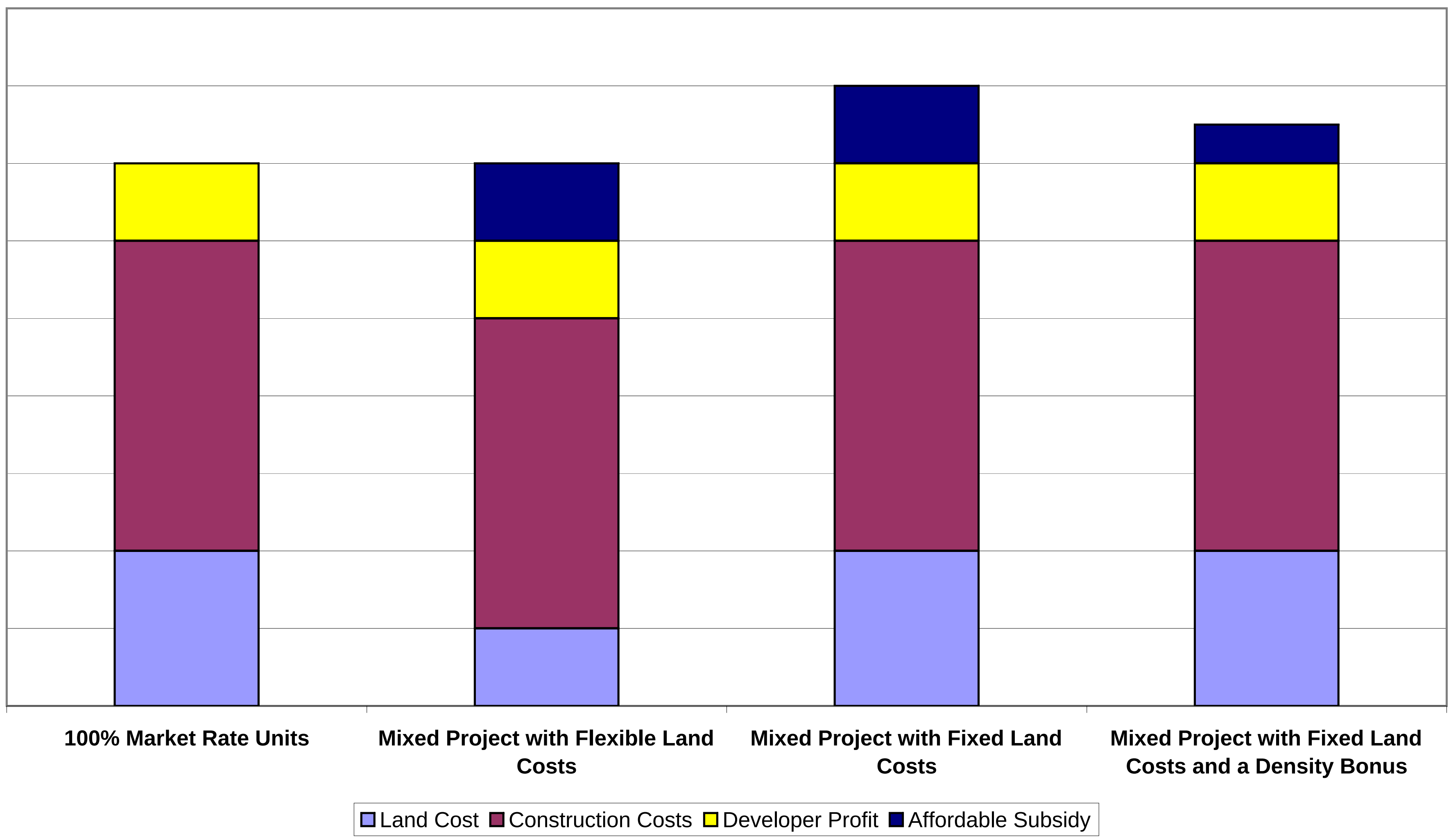


Figure 3
Density Bonus Scenarios
Comparison of Net Revenues (Development Values less Costs)

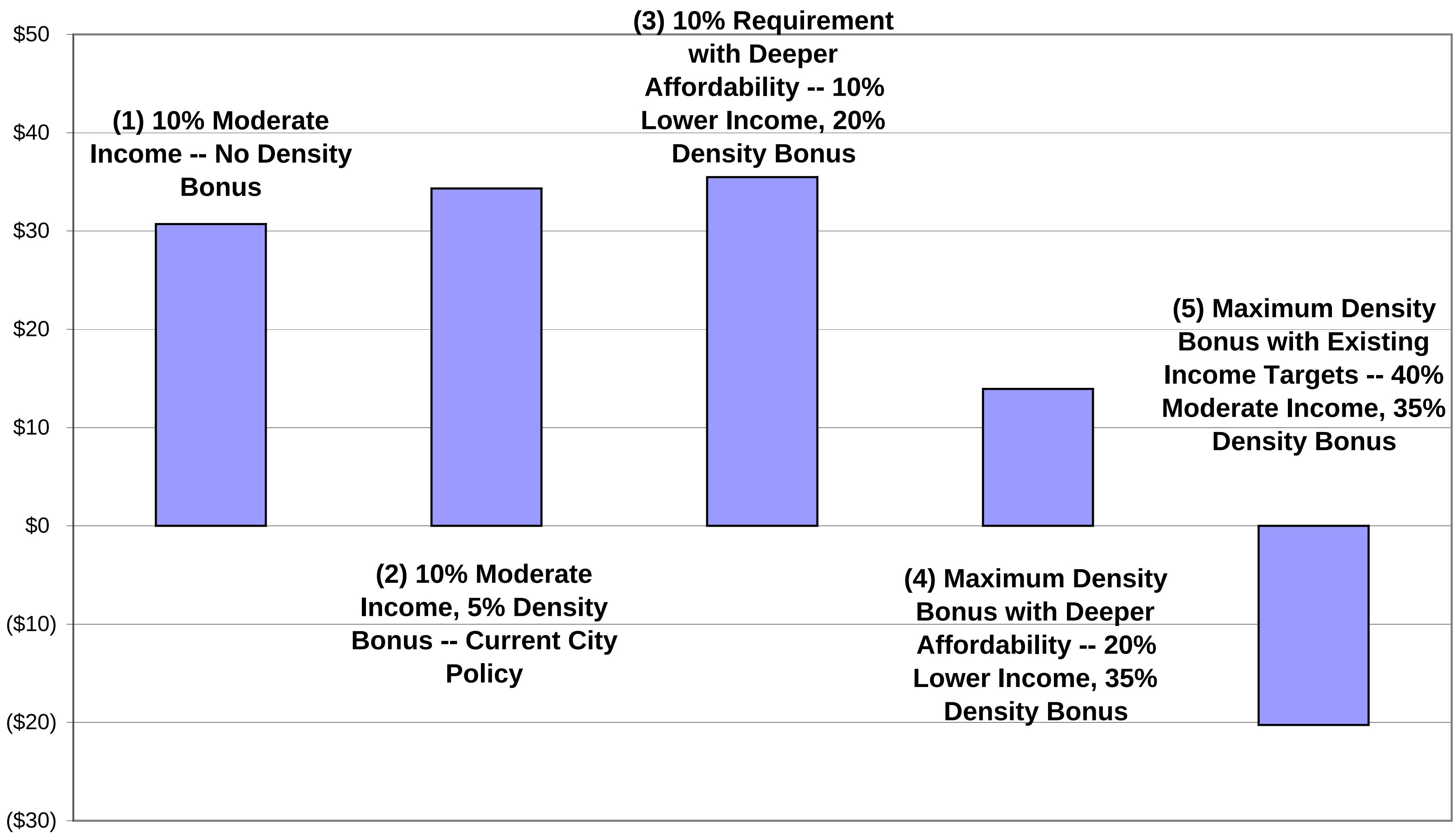
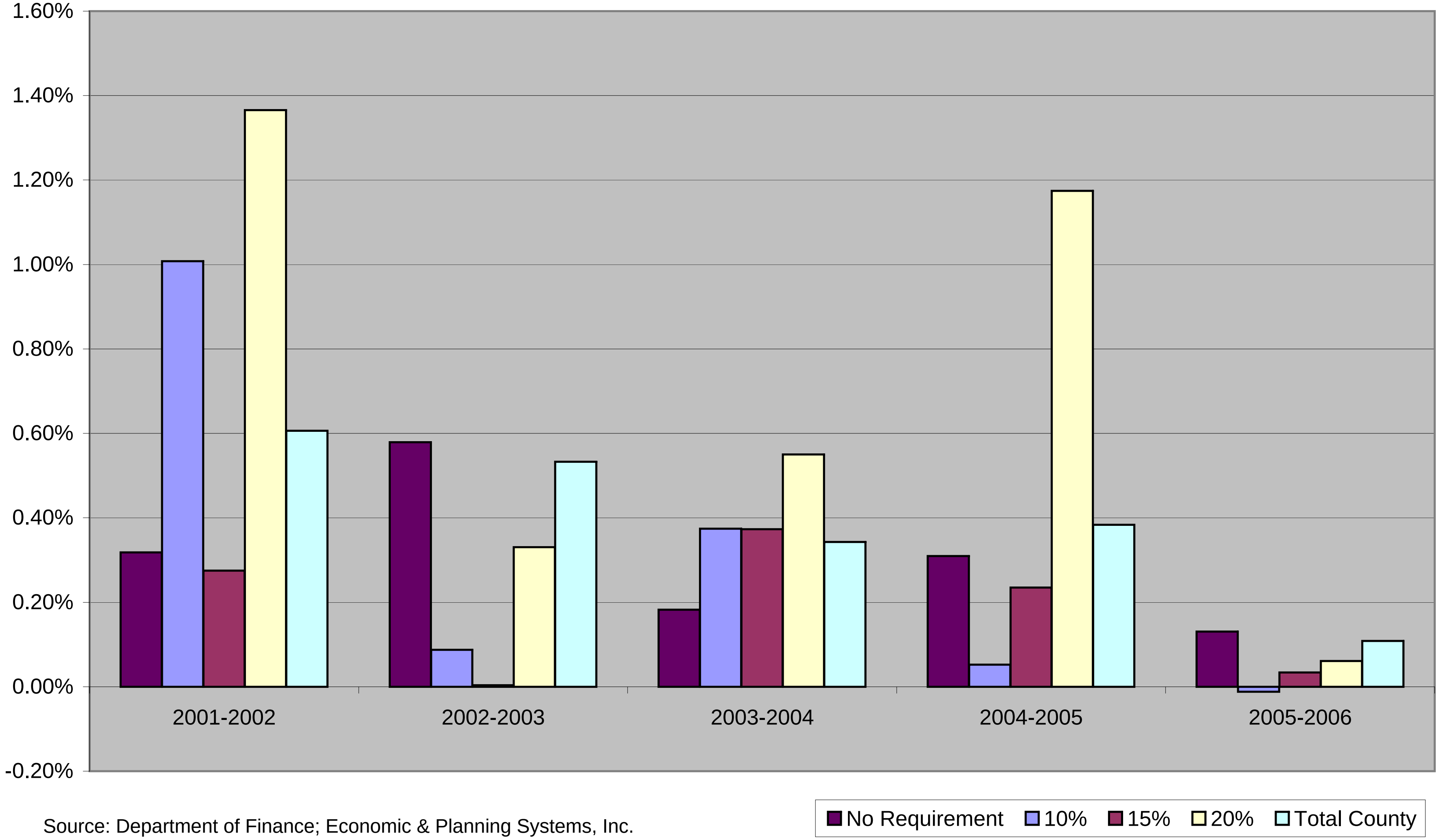


Figure 4: Comparison of Annual Housing Unit Growth By Inclusionary Requirement For Jurisdictions in San Mateo County



Source: Department of Finance; Economic & Planning Systems, Inc.

Appendix A
Inclusionary Housing Policy Options
San Mateo Housing, EPS #16078

Component	Current Provision	Potential Changes	Policy Issue(s)	Impact of Density Bonus	Feasibility Finding
Percentage of Affordable Units	10% minimum Redevelopment Area: 15% minimum	Measure P requires 10% minimum, but could allow an increase to the BMR requirement for all projects or for projects over certain size thresholds.	Neighboring jurisdictions require 10% to 20%.	Effectively reduces the percentage of affordable units for the project through the bonus of additional market rate units, not subject to additional BMR units.	Project feasibility is reduced as the percentage of affordable units increases.
Applicable Project Size	11+ units	Decrease the applicable project size or create a tiered requirement that increases the affordable requirement as project size increases.	The project size applicability in neighboring jurisdictions ranges from 1 unit to 11+ units.	A density bonus is allowed for projects of 5+ units.	Larger projects may be able to support higher inclusionary requirements due to economies of scale.
Affordability Requirements	Ownership - Moderate Income Rentals - Lower Income Redevelopment Area: 9% Moderate Income, 6% Very-Low Income	Reduce the affordability targets to lower income for ownership units and very-low income for rental units.	Market-rate rentals are already affordable to moderate and some lower income households. Provides no ownership opportunities for lower income households. Other jurisdictions target very-low and lower incomes for rentals and lower and moderate incomes for ownership.	Higher bonuses provided for very-low and lower income targets vs. moderate income targets and more developer concessions.	Lowering affordability targets for rental units slightly reduces project feasibility. Lowering incomes would have more substantial impacts on ownership projects.
Design Flexibility of BMR Units	Number of bedrooms must be proportionate to market rate units and be comparable in size, with units distributed throughout the project. Also, Measure P requires that the exterior of BMR units be similar in appearance to the market rate units.	BMR ordinance could be amended to allow BMR units to be smaller or have different number of bedrooms than market-rate or cluster in one location in exchange for more units.	In some cases, allowing the BMR units to be completely different from market rate units (single-family market rate units and multi-family BMR units) makes more sense and results in more affordable housing.	State density bonus law does not require that BMR units be equivalent in size or exterior to market-rate units.	Allowing BMR units to be smaller than market rate units enhances feasibility, and could allow for a higher percentage of overall units to be BMR. The clustering of BMR units could enhance project feasibility through economies of scale or additional subsidies obtained by non-profit developers.

Appendix A
Inclusionary Housing Policy Options
San Mateo Housing, EPS #16078

Component	Current Provision	Potential Changes	Policy Issue(s)	Impact of Density Bonus	Feasibility Finding
Offsite Option/ Land Dedication	Measure P allows offsite units only if the developer can demonstrate that on-site construction is infeasible. Any offsite units must be completed and occupied prior to completion of the development project.	Define a standard for a finding of "infeasibility." Increase the BMR requirement for off-site units. If overall BMR percentage is increased to more than 10%, could allow units above base 10% to be built or dedicated offsite.	The option to construct offsite BMR units can be more efficient and therefore result in the construction of more affordable units. Some of the neighboring jurisdictions allow this.	Land donations qualify for a density bonus. However, the bonus is less for land donations than onsite construction.	Setting aside sufficient land for a third party to construct the 10% BMR requirement increases the feasibility of the project. This implies that the subsidies required to construct the BMR units onsite, cost more than donating the land.
In Lieu Fees	No in-lieu fees are currently allowed.	Measure P does not allow in-lieu fees for units that meet the minimum 10% BMR requirement, but could possibly allow in-lieu fees for units above 10% requirement if required percentage of affordable units is increased. Measure does allow fees for projects less than 11 units, or fractional affordable requirements less than 0.5. BMR ordinance could allow partial units to be funded through in-lieu fees rather than rounding to nearest whole number.	The allowance of in-lieu fees can sometimes result in the construction of more affordable units, as seen in luxury developments requiring very large subsidies for BMR units. However, it is important that the fees not be too low, otherwise developers will always choose to pay an in-lieu fee and inclusionary housing would not occur.	State density bonus law does not address whether projects that pay in-lieu fees for affordable units qualify for a density bonus.	Payment of fees may enhance the feasibility of market-rate development by allowing construction of additional profit-yielding units.
Pooling/ Credit Transfers	Measure P allows only if the "infeasibility" requirement for offsite construction is met.	Define a standard for a finding of "infeasibility." Increase the BMR requirement for off-site units or pooling. If overall BMR percentage is increased to more than 10%, could allow units above base 10% to be built or dedicated offsite, including pooling.	Can result in greater efficiencies and therefore even more production of affordable units.	State bonus law does not address this issue directly, but land donation qualifies for a density bonus.	Offsite BMR construction and pooling/credit transfers can enhance the feasibility of the project when the subsidies required to construct the BMR units cost more than construction on an alternative site.
Density Bonus	State law provides 5-35% increase over allowed densities for each zoning class, depending on the amount of affordability. State law also indicates that cities must provide incentives to enhance project feasibility.	Grant greater density bonus than required as minimum by State law, as long as the project conforms to height and FAR standards.	City's current zoning and Measure P allow 9-50 units per acre. State density bonus law undermines local planning and zoning law.	State law specifically calls for density bonus above existing allowances.	Up to a point, the density bonus can enhance the feasibility of a project by increasing revenues from added market rate units.

Appendix A
Inclusionary Housing Policy Options
San Mateo Housing, EPS #16078

Component	Current Provision	Potential Changes	Policy Issue(s)	Impact of Density Bonus	Feasibility Finding
Developer Incentives/ Concessions	State bonus law requires a reduction of development standards such as setbacks, FAR, architectural modifications, etc. A 5% development fee reduction is currently available.	Define applicable "incentives" to enhance feasibility, possibly including variances to heights, setbacks, parking ratios, etc. as well as impact fee reductions.	More incentives may offset the cost increases associated with inclusionary housing requirements and height increases may be an incentive to enable increased density. The incentives/concessions required by the state density bonus law undermines local planning and zoning law.	Entitled to up to 3 concessions, depending on the amount of affordability. State law may override Measure P regarding height limits and FAR, but not the underlying zoning of the parcel. In addition, the City is not required to offer fee reductions if asked for by the developer.	Project feasibility can be slightly enhanced by more concessions/incentives, such as a reduction in development fees.