VII. AFFORDABLE HOUSING

POLICY ISSUES

Review the Below Market Rate (BMR) Program percentages, affordability levels, and location and types of BMR units.

Examine adoption of a commercial linkage fee for new non-residential development?

BACKGROUND

Housing Element

An important part of the City's Housing Element is an analysis of the City's ability to provide for its "fair share" of housing. For the City's adopted Housing Element, the Bay Area's regional housing need (RHNA) was first allocated by the State of California Department of Housing and Community Development (HCD), and then finalized for specific jurisdictions by the Association of Bay Area Governments (ABAG). Cities are required to identify enough land zoned at appropriate densities to accommodate the RHNA need for housing of various household income categories. For the current Housing Element cycle, San Mateo is required to have enough land zoned to accommodate 2,437 new housing units.

In addition to the RHNA goals, each city establishes goals for the actual construction of new units. According to HCD, the City's Goals should ideally be equal to or surpass the community's identified housing needs. However, the State recognizes that the total housing needs identified may exceed available resources. Under these circumstances, the City goals need not match the identified existing housing needs but should establish the number of housing units that can be constructed, rehabilitated, and conserved over a five-year time frame. Although cities don't construct housing directly, they can develop programs and policies in the Housing Element to encourage production. This includes a limited amount of funds to provide financing to subsidize affordable units. San Mateo's affordable housing units are provided in two ways: Below Market Rate units located in private market rate housing developments, and units directly subsidized with City and Redevelopment Agency funds. In establishing the City goals, San Mateo generally reviews market trends in construction coupled with estimated financing resources to assist affordable units.

The City's five year (2001 – 2006) RHNA, City Goals and current progress are shown below:

Figure 9
RHNA and City Goals for Housing

	Regional Housing Need	City Goals	Completed or under Construction	% of RHNA Goal	% of City Goal
Very Low Income	479	160	129	27%	81%
Low Income	239	180	90	38%	50%
Moderate Income	673	70	48	7%	69%
Subtotal Affordable	1,391	410	267[1]	19%	65%
Market Rate	1,046	1,500	1,425	136%	95%
TOTAL	**2,437**	**1,910**	**1,597**	**69%**	**89%**
[1] Affordable Unit Breakdown:					
Santa Inez Apartments			44		
Rotary Floritas			50		
First Step for Families			15		
BMR Units			158		
			267		

During this current Housing Element cycle, the construction of market rate housing has exceeded the RHNA requirements but fell short of the City goal. Of the 267 affordable housing units produced, 109 were directly assisted with City financing and 158 were produced by market rate developers as a result of the City's Below Market Rate (BMR) Program. However the combined affordable units fell short of the City's expectations due to increased costs of development, dwindling financial resources, and the difficulty to acquire suitable sites.

For the upcoming Housing Element revision and re-certification process, review of preliminary data supplied by ABAG indicates that the City of San Mateo's regional housing need allocation will be approximately 3,051 units. It is anticipated that the City will not be able to meet the affordability goals that ABAG will establish due to the financial constraints to assist affordable units based on the City's past experience.

Housing Needs

The RHNA goal is a regional estimate of San Mateo's housing needs based on projections by economists, but there are other indicators in the community that demonstrate the need as well. The 2000 Census shows that one third of San Mateo residents pay more than 35% of their income toward housing (30% is the commonly used definition of "affordable"). The median income

household of $95,000 per year can afford a mortgage of $360,000, yet the median condominium in San Mateo County is priced at $605,000 based on sales for the quarter ending June 2007.
In addition, the wait lists for the existing BMR units are long. Over 500 families are on the rental waiting list and over 225 are on the first time buyer list, which includes BMR units. The available units are not always a match for those on the wait list. For example, over 300 families on the rental list are waiting for very low income units, yet there are only 42 of those units in the program. Another example is that there are 120 families on the 3 bedroom list, waiting for one of the 46 larger units to come up for sale, which historically occurs once or twice a year.

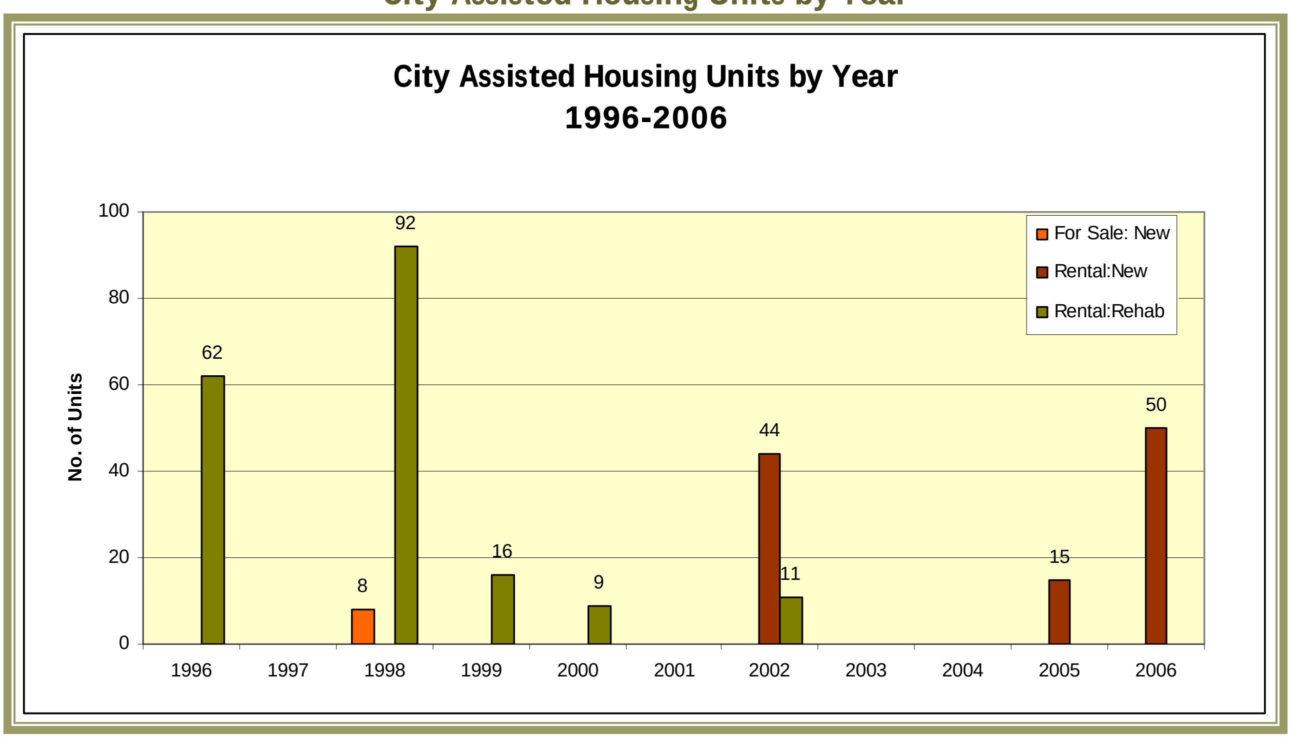
Housing Strategy

In order to plan for the construction of new housing units to meet the full range of housing needs for the community, the Housing Element describes several programs.

City Resources for Affordable Housing

Each year the City of San Mateo receives HOME funds, a federal grant for affordable housing, as well as a portion of redevelopment tax increment funds designated for housing. These resources are used to leverage additional state, foundation and private funds to construct and preserve affordable housing in San Mateo. During the past 10 years the City and its Redevelopment Agency provided $16.2 million to assist the new construction of 117 affordable units, and the acquisition and rehab of 190 units. Figure 10 shows the assisted housing units completed by year.

Figure 10
City Assisted Housing Units by Year



The cost per unit of City funds for affordable housing varies depending on the type of project, the year it was built, and what other funds were leveraged to assist the project. Typical subsidy costs are displayed below in Figure 11.

Figure 11
City Subsidized Housing Units 1996-2006

	Total Funds	No. Units	Average Subsidy per Unit	Average City $ as % of Total Development Cost
New Construction	8,600,000	117	73,500	20%
Acquisition/Rehab	7,600,000	190	40,000	42%
Total	16,200,000	307		

During the 2006-07 fiscal year, an additional $13.2 million was spent on the acquisition of three sites that have the potential to provide up to 180 additional units over the next few years at an average cost of $73,000 per unit. These sites include the Vendome Hotel located downtown, the Goodyear site on El Camino Real, and the existing police station which will become available for redevelopment when the new police station construction is completed in 2009. The complexity of financing these projects and the competitiveness of obtaining outside funds such as tax credits, or other State financing, generally require them to be 100% affordable. As a result, the City will be able to provide the most affordable units in the community.

The purchase of these sites has depleted the reserve of City housing funds available. In 2005, the Redevelopment Agency issued $5 million in housing bonds which were utilized in the site purchases this past year. The debt service of these bonds, prior bonds, and ongoing program administration, including the housing rehabilitation and first time homebuyer programs leave substantially less available for new housing assistance for the next several years. The federal HOME program grants to San Mateo have decreased over the last few years and may continue to decrease in the future as well. Figure 12 shows the historical and estimated future funds for San Mateo. It is anticipated that in the next five years, an additional $3.5 million will be accumulated that could leverage another 30-45 units. Finding additional resources for affordable housing will be a high priority for the next housing element cycle.

Figure 12
Estimated Resources for New Affordable Housing*

				Future Funding				
	Balance 6/05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
RDA Hsg. Set Aside	6,000,000	682,000	1,500,000	200,000	200,000	200,000	200,000	200,000
RDA Hsg. Bonds	-	5,000,000						
HOME	-	546,000	514,000	511,000	506,000	502,000	498,000	494,000
Total	6,000,000	6,228,000	2,014,000	711,000	706,000	702,000	698,000	694,000

* Excludes ongoing costs of debt service and program administration

Figure 13

City of San Mateo

Below Market Rate Program Incomes and Housing Prices

TARGET GROUP	INCOME		BELOW MARKET RATE HOUSING PRICES			
	MONTHLY	ANNUAL	UNIT SIZE	RENT	SALES PRICE CONDOS	SALES PRICE SF DETACHED
VERY LOW INCOME						
50% AMI						
1 Person	2,771	33,250	*STUDIO*	830	103,000	
2 Person	3,167	38,000	*1 BR*	950	122,000	
3 Person	3,563	42,750	*2 BR*	1,070	142,000	
4 Person	3,958	47,500	*3 BR*	1,190	161,000	
5 Person	4,275	51,300	*4 BR*	1,280	176,000	
LOWER INCOME						
80% AMI						
1 Person	4,433	53,200	*STUDIO*	1,000	162,000	
2 Person	5,067	60,800	*1 BR*	1,140	190,000	
3 Person	5,700	68,400	*2 BR*	1,280	218,000	
4 Person	6,333	76,000	*3 BR*	1,430	245,000	
5 Person	6,840	82,080	*4 BR*	1,540	267,000	
MODERATE INCOME						
120% AMI						
1 Person	6,650	79,800	*STUDIO*	1,830	203,000	n/a
2 Person	7,600	91,200	*1 BR*	2,090	237,000	313,000
3 Person	8,550	102,600	*2 BR*	2,350	271,000	357,000
4 Person	9,500	114,000	*3 BR*	2,610	304,000	400,000
5 Person	10,258	123,100	*4 BR*	2,820	331,000	435,000
MARKET RATE HOUSING:						
(San Mateo County)						
Average Market Rent (REAL FACTS June 2007)			*1 BR*	1,487		
			2 BR	1,692		
Median Sales Price (SAMCAR Qrtr ending 6/07)					605,000	970,000

Denotes Current BMR Prices

Below Market Rate Program

The BMR program provides a vital role in the City's goals to plan and assist the development of new affordable housing. Developers who construct projects with 11 or more units are currently required to provide 10% of the units to be affordable. The BMR units for newly constructed rental units are targeted to "lower" income households (less than 80% of median income) and ownership units are targeted to "moderate" income households (less than 120% of median income). (See Figure 13.) The BMR units must be included onsite, dispersed throughout the project, and the number of bedrooms in BMR units must be provided at the same ratio as the market rate units. BMR units are allowed to be constructed offsite if the developer can demonstrate infeasibility and only if they are completed at the same time or sooner than the market rate units. One of the basic principals of the BMR program is that it scatters affordable housing units throughout the community over time so the units blend in with the community at large.

The first BMR units were completed in 1996. Since the inception of the program, permits for 2,381 new market rate residential units have been issued, which generated 234 affordable units (164 rentals, and 70 ownership units) located in 21 different developments. To date, no project has utilized the offsite construction option.

The BMR units represent more than 40% of the affordable units provided during that same time period. Figure 14 demonstrates the significance of the BMR units as a component of the entire affordable housing accomplishments from 1996-2007. For the most part, this program provides lower and moderate income housing, whereas the units assisted with City financing primarily target very low income households. Details of the type of BMR units produced and their affordability levels are summarized in Figure 15.

Figure 14
Affordable Units 1996-2006

	Very Low Income	Low Income	Moderate Income	Total
City Assisted Units: New	130	2	9	141
City Assisted Units: Rehab	106	76	8	190
BMR Units	49	87	98	234
Total	285	165	115	565

Figure 15
City Of San Mateo BMR Summary
1996-present

	Year		Affordable Units		Income Group			Unit Mix				
	Completed	Total units	# units	%	Very Low	Low	Moderate	1 BR	2BR	3BR	4 BR	Program
Ownership												
Corte Bella	1996	124	12	10%			12		12			BMR
Rushmore Townhomes	1998	13	1	8%			1			1		BMR
Madrid Townhomes	2000	13	1	8%			1		1			BMR
St. Matthews Place	2000	34	5	15%	2		3		5			RDA
Ryland Homes	2001	153	15	10%			15		9	3	3	BMR
Norfolk Properties	2002	67	7	10%	5		2	2	5			DB
Classic Communities	2002	25	3	12%			3		1	2		BMR
Grant St	2002	17	2	12%			2	1	1			BMR
Park Place	2003	19	2	11%			2		2			BMR
Baywood Place	2004	17	2	12%			2		2			BMR
Stonegate	2007	45	9	20%			9	1	7	1		DB
Palm Residences	2007	19	2	11%			2	1	1			BMR
Verona Ridge	est 2008	34	3	9%			3				3	BMR
Versailles	est 2008	59	6	10%			6	1	5			DB
Park Bayshore	est 2008	21	2	10%			2		2			BMR
Subtotal-Owner		660	72	11%	7	0	65	6	53	7	6	
*Total FTB units**			*242*		*7*	*15*	*220*	*62*	*128*	*46*	*6*	
Rental												
Bridgepointe	1999	396	59	15%	24		35	29	28	2		RDA
Jefferson at Bay	2002	575	58	10%		58		31	23	4		BMR
Chamberlain	2002	21	2	10%		2			2			BMR
Prometheus Metropolitan	2003	218	22	10%	18	4		11	11			DB
College of San Mateo	2005	44	4	9%		4		2	2			BMR
Nazareth Plaza	2006	54	5	9%		5		1	4			BMR
FountainGlen	2007	135	14	10%		14		10	4			BMR
Subtotal-Renter		1443	164	11%	42	87	35	84	74	6		
Grand Total		2103	236	11%	49	87	100	90	127	13	6	

* Includes other City FTB units at Gateway Commons, Meadow Court, and Humboldt Square

Redevelopment Project Areas

There are special inclusionary provisions in the Downtown and Shoreline Redevelopment Project Areas to comply with California Redevelopment Law. Redevelopment law requires that 15% of all the units constructed within the project areas be affordable-- at least 6% for very low households and 9% for moderate income households. Although the law does not specify how the units are distributed, San Mateo has implemented a "pay as you go" approach and requires that each project provide 15% onsite to ensure that the requirement is met over time. Therefore the affordable housing requirements in these areas are stricter than the citywide 10% BMR requirement.

DISCUSSION/RECOMMENDATIONS

Although the precise affordable housing goals of the regional fair share for the next Housing Element cycle have not been established, the goal will most likely be higher than the current allocation of 1,391 very low, low and moderate income units. Historically the private market does not provide any of those units in San Mateo, so the combination of direct City financial assistance and the inclusionary units in the BMR program are the means to achieve affordable units. Over the next five year planning period, up to 180 units may be built on sites already purchased using City housing funds, and anticipated future local funds could assist another 30-45 units. Any other county, state or federal funding sources that may be available to support more affordable housing are competitive and cannot be relied on at this time. Therefore the City's BMR program is a key component in the overall affordable housing strategy. The BMR program provides two opportunities to provide future affordable housing: 1) the direct construction of units, and 2) the collection of fees to augment the City's depleted housing funds.

Given the current need and estimates of continued demand for housing, one approach is to increase the affordability requirements that developers must provide under the BMR program. However it must be recognized that BMR requirements do increase the cost of constructing housing and BMR units will only be provided if it is attractive for market rate developers to build in San Mateo. Part of the City's housing need includes market rate housing as well as affordable units, so care must be taken that market rate housing construction is also encouraged.

Who Pays?

A frequent concern of the impacts of the BMR program is how the additional development costs are absorbed or whether they are passed on to the market rate consumers. The EPS report in Appendix D discusses how these costs impact a project. Typically, a developer faces somewhat fixed construction costs, and expects a certain rate of return. Since the anticipated sales prices or rents of the new units are controlled by market demand, the only remaining factor in decreasing development costs is land. If there is competition for land for non residential uses then land prices are less flexible. If in this case the developer cannot absorb the extra costs and maintain the expected profit, the project will not likely move forward. If there is not demand for the land for non residential uses, and the developer cannot absorb the extra costs, the developer will only move forward if the price of the land is reduced.

Policy Issues

Since increasing the BMR requirements has financial impacts on development costs for new residences, staff and the TAC considered the following interests in discussing this issue:

- Increase the supply of affordable housing units in San Mateo
- Preserve the existing character of existing neighborhoods
- Uphold the provisions of Measure P
- Ensure that BMR restrictions do not make development of market rate housing infeasible
- Ensure the BMR program reflects the interests of both residents and developers

In addition to these interests, it was noted that the more certainty in city requirements early in the development design process, the easier it is for developers to incorporate those requirements into a successful and viable project.

Strengths and Weaknesses of Current BMR Program

Strengths

The existing program has successfully provided units in several locations around the city and since the units are scattered within individual developments, they cannot be distinguished from the market rate units. This gives buyers and renters more housing choices and avoids over concentration in any given location. As discussed earlier, the BMR program has produced 234 units since inception of the program, which represents major component of the affordable housing built since 1996.

Unlike cities that collect in lieu fees for BMR units, San Mateo's BMR's are developed concurrently with the market rate units. One of the potential risks with in lieu fee programs is that it takes time to save up enough fees to support new housing projects which delays the time that affordable units are available to families. San Mateo's BMR units are provided without any time delay and often are leased or sold more quickly than the market rate units in a project.

Weaknesses

Since BMR units are located in all new developments, a wide range of unit styles and amenities are available to prospective buyers. While the purchaser of a BMR unit in a luxury complex gets the opportunity to live in a desirable location at an affordable price, one concern is the future affordability of Home Owners Association (HOA) dues over time. The estimated initial HOA dues are taken into account when the initial sales price is established for BMR units, so the unit is affordable for BMR buyers at the beginning. However the dues for properties with costly upkeep will increase over time at a faster rate than other projects. These dues are totally managed and established by the HOA board and therefore are difficult to predict whether they will become unaffordable for BMR owners. The same is true of special assessments for common area repairs and replacement that are needed from time to time.

Another issue for luxury market rate projects is the current requirement to provide "like" units as BMR's, which can impose a significant cost to the developer for the amount of benefit gained. For example a current project under construction provides 2-bedroom units for a BMR sales price of $271,000. The estimated sales price for similar market rate units will start at $775,000. For each BMR unit provided to the program, the developer will lose about $500,000 in sales revenues had the BMR units been sold at the market rate. Although the developer has included these costs in the overall budget, and believes the project as a whole will be profitable, the cost to provide a first time buyer unit is an extremely inefficient cost per unit. That same $500,000 could leverage 3-5 units in an affordable rental project where the City would typically provide assistance. This cost is even more extreme in a single family detached development or other extremely high end condominium projects.

In this situation, several cities have allowed, or even preferred, to capture in lieu fees or allow offsite construction, in order to get more affordable units for the same developer contribution. For example, Mountain View collects in lieu fees for projects where the market rate units sell over a pre-determined bench-marked sales price. Palo Alto negotiates each project on a case by case basis in order to maximize the affordable unit counts and will either allow units constructed elsewhere or collect a fee. In San Mateo County, many cities allow some flexibility instead of providing BMR units onsite. Six cities will allow an in lieu fee if an option for onsite construction is infeasible. Nine cities will allow offsite construction depending on a variety of factors including developer infeasibility, the local need for units, or an increase in the number of affordable units. These are all examples of ways to add flexibility to a program to increase the number of affordable units.

Another weakness in the current program is the vagueness of the offsite provision to build BMR units that is allowed under Measure P. There is a provision to construct the BMR units offsite if it is determined to be infeasible to construct onsite. At this time there is no precedence or guidance for staff or developers on how to define "infeasible". The inclusion of some parameters for infeasibility could clarify this provision in the future.

RECOMMENDATIONS

In an effort to increase the amount of affordable units constructed, collect additional funds to support affordable housing, and acknowledge the costs associated with the requirement of BMR units to new residential projects in the future, the following recommendations are proposed.

1. Change BMR Inclusionary Requirement

San Mateo's current requirement of 10% is amongst the lowest in San Mateo County. 7 cities in the county have a requirement of 15%, while in unincorporated areas of San Mateo County and 5 other San Mateo County cities the requirement is 20% (See Figure 16 and Tables 1 and 2 of the EPS study in Appendix D for additional details). EPS analyzed whether the adoption of inclusionary requirements by cities impacted development patterns by comparing building permits issued before and after adoption of policies, but found no conclusive evidence one way or another. San Mateo's own past experience would suggest that increasing the BMR requirement would cause a temporary period of adjustment as developers and land owners determine the cost impacts.

The recommendation is to raise the overall BMR requirement to 15% and maintain the current income targets of the program. Since the BMR rent levels for "lower" income does not nearly meet the needs for a large percentage of households on current waiting lists, the option was developed to encourage the production of "very low" income rental units by reducing the required percentage to 10%. The development models prepared by EPS indicate that the cost to the developer to provide 10% very low income rentals is fairly equivalent to 15% lower income rentals, so both options should have similar economic impacts on a project..

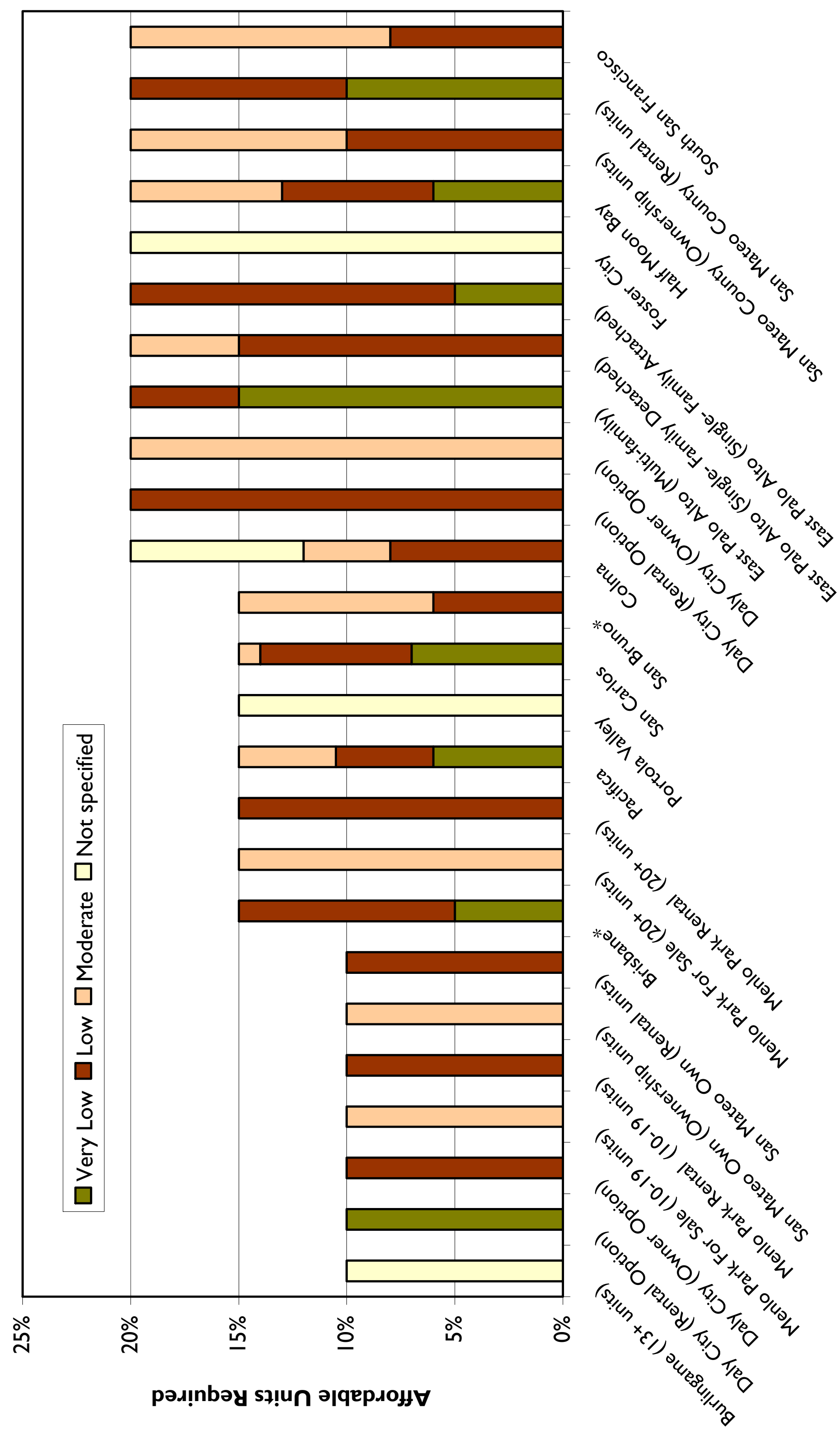
RECOMMENDATION:

Increase the BMR requirement to 15% citywide at current income targets of "lower" income for rentals, and "moderate" income for ownership. Rental Option: 10% "very low" income.

Alternate BMR Requirement

The United Homeowners Association suggested that the BMR requirements be tiered according to project size. Projects sized from 11-50 units would require 10% BMR units, 51-100 units would require 12% and projects with 101 units or more would be required to provide 15% BMR units. This is based on the assumption that larger projects have some economies of scale and can more easily afford the higher BMR requirement. While this is often the case, the construction cost for a unit is more dependent on the type of construction than the size of the project. For example, the per-unit cost of 50 units in a townhouse project is much less expensive than the per-unit cost of 50 units in a high rise constructed with steel. There is also concern of the unintended consequence of developers submitting smaller projects to avoid the requirement of the next tier. There are examples in the past of residential projects that have been scaled back by developers to 10 units or less to avoid the cost of the BMR requirement. It is assumed this would happen to a certain extent for any threshold that is implemented If this option is considered by Council, staff would recommend lowering the proposed unit threshold in order to generate more affordable units. Over the last 10 years, the median project size of approved projects is 26 units. Out of a total of 33 approved residential projects, 3 were sized 51-100 units, and 7 were over 100 units, so not many projects would fall into the upper tiers. Menlo Park uses an approach that has one requirement for projects sized 10-19, and a higher requirement for projects over 20 units. Another approach would be to look at a sliding scale that is much more gradual, which is how the Town of Los Gatos structured their program.

Figure 16
Comparison of Inclusionary Housing Policies in San Mateo County



*Inclusionary policy, but no ordinance

BMR Unit Projections

Currently there are planning applications and pre-applications for about 900 housing units in the pipeline. It is very possible that some of these proposals will not get approved, but assuming they ultimately get built, 90 BMR units would be constructed under the City's current 10% standard. Any changes to the program will not likely impact projects already in the pipeline. Also, the preliminary plans for Bay Meadows II show 1066 housing units which will generate 107 BMR's (not including the one acre site to be given to the City for another affordable housing project). Over the next five years, it is anticipated that another 1000 units could be built that would be subject to any revisions to the BMR program. Under the current program 100 BMR units would be produced, which would increase to 150 if the requirement is changed to 15%. If we assume new projects would be sized based on the trends of the past 10 years, then the tiered approach would generate 117 BMR units.

Figure 17
BMR Options Estimated Production

	No. of Units	Current BMR 10%	Proposed Tiered 10-15%	Proposed 15%
Bay Meadows II (subject to current standards)	1,066	107	107	107
Estimated Pipeline PA's (subject to current standards)	900	90	90	90
Future Projects (subject to new standards)	1,000	100	117	150
Totals	2,966	297	314	347

Impacts on Redevelopment Areas

The proposed 15% citywide BMR requirement satisfies Redevelopment law so the total number of affordable units will be met automatically, but the affordability targets differ from the RDA obligation of 9% moderate and 6% very low income units. The existing RDA income targeting does not differentiate between rental and ownership units and therefore creates pricing requirements that are quite different from the citywide BMR practices and can be out of sync with the City's overall goals. In a rental situation, the 9% moderate income requirement allows rents that are above market averages. For example, BMR rents at Bridgepointe, in the Shoreline Redevelopment Area, are allowed to be up to $2,100 for a 2 bedroom unit. Conversely, requiring 6% very low income BMR's in a for-sale project puts an additional financial burden on the developer since the restricted price for a very low income 2 bedroom unit is currently $142,000 rather than the moderate sales price of $271,000. This situation has the unintended effect of discouraging construction of housing in the Redevelopment Areas, especially in the Downtown where development has more physical constraints.

It is recommended to apply the 15% low or moderate income targets in Redevelopment areas in the same manner as other parts of the City for consistency. As a result of this change, the 6% "very low" requirement for the project areas would then become the responsibility of the Redevelopment Agency. Currently all previous very low income obligations have been met in the Redevelopment Areas. Since Redevelopment law does not dictate the location of the affordable units, they can be built outside of the redevelopment area at a two for one ratio and still comply with the project area requirements. This obligation is tracked as part of the Redevelopment Implementation Plan updates and progress reports. Over the past several years the Redevelopment Agency has used its Housing Set-Aside funds to assist very low income units that can be counted toward the project area obligation. As of December 2006 the Agency had a "credit" of 64 affordable units that can be applied to future project area obligations. This can offset the very low income requirement for the construction of over 1,000 market rate units in the Redevelopment areas. Over the next few years the units that are developed at the Good Year site and the Vendome Hotel will be added to that surplus, so that it is unlikely the Agency will ever be out of compliance for the foreseeable future.

RECOMMENDATION:

Apply the citywide BMR income targets to the Redevelopment Areas.

2. Fractional Unit Fees

Measure P allows that a fractional fee could be collected for projects under the threshold of 11 units and fractional BMR requirements of less than 0.5. This provision was included as a revision to Measure H, but the City has not yet adopted this as policy. This would spread the affordable housing requirement to more projects on a proportionate basis.

A number of cities in San Mateo County collect fees for small projects under the threshold to provide affordable units onsite. Most impose the fee on projects that consist of 4 or more units, although San Carlos collects the fee on 2 or more units. Therefore, for some consistency with other jurisdictions, it is recommended that the City adopt fees for projects sized between 4 and 10 dwelling units.

Currently, for projects of 11 or more units, the number of required BMR units is calculated by rounding up from 0.5 units or more when a fraction occurs. For example, a 15-unit project would require 1.5 BMR units which rounds up to the construction of 2 units. A project with 14 units requires 1.4 units, which is rounded down to 1 unit. Therefore, it is recommended to also collect a fractional fee on a sliding scale for any fractions that occur in the range of 0.1 to 0.4 in all projects greater than 11. In this case, a 14 unit building would provide one unit and pay a fee for the .4 fraction of a unit, and a 24 unit building would provide 2 units onsite and pay a fee for .4, etc.

RECOMMENDATION:

Adopt fees for fractional units for projects sized between 4-10 units. Adopt fees for fractional units of 0.1-0.4 for projects with 11 or more units.

Based on the number of units in approved projects over the past 10 years the proposed fee could have generated up to $3 million based on preliminary in lieu fee calculations developed by the economic consultant.

3. Offsite Construction and Land Dedication

Since Measure P allows offsite construction of BMR units if it is "infeasible" to build onsite, defining "infeasible" could provide some clarity for developers. In some cases there seems to be certain logic that BMR units may be extremely costly and perhaps not be a good fit in high end luxury projects. The challenge is how to differentiate those scenarios from others, so that both staff and developers can make a determination early in the planning process.

Webster's Dictionary defines infeasible as "not capable of being carried out or put into practice; impracticable; unsuitable." It is assumed that the reason a developer would want to build BMR units offsite would be due to "economic" infeasibility because the project would not make economic sense. This would most likely occur in projects that consist of units that are very expensive to build due to high development costs, excessive homeowners' association dues, or site constraints such as shape, topography, geologic or toxic conditions. The Verona Ridge project is an example of large, luxury single family homes, whose construction costs will far exceed the restricted prices that the developer will sell the BMR units. A couple of cities have tried to address this by defining "luxury" to determine when to relieve developers from the onsite requirement. Mountain View has established a projected sales price as a threshold; however it is currently so low it covers almost all new multi-family construction. Palo Alto tried to tie construction costs of a unit to the BMR restricted price for awhile, but then dropped that practice since it took so much staff time to negotiate with developers what costs to include in the formula.

Some cities take a different approach and allow offsite construction only if the number of units provided offsite exceeds what they would have obtained onsite (San Carlos and Palo Alto), or if it furthers another housing goal identified in its Housing Element (South San Francisco).

Other cities, such as Menlo Park, have no definition, but simply negotiate infeasibility on a case by case basis. This option provides more flexibility, but creates uncertainty and the potential for inconsistency in its application. This scenario would require the developer to provide a project cost pro forma that compared the costs of providing BMR units onsite versus offsite.

It is recommended that San Mateo require a developer to provide written justification including project cost estimates to demonstrate the economic infeasibility of providing BMR units onsite.

Density Bonus law allows land dedication in lieu of building affordable units onsite under a set of very specific circumstances. Another option for San Mateo is to use these criteria as an alternative for offsite construction in the case of infeasibility.

The basic provisions of the land dedication option are that a developer provides the City a site that is at least one acre in size, zoned at least 40 units to the acre, and is located within 1/2 mile of the market rate site that is agreeable to the City. The affordable units are required to be very low income and a density bonus is less than if they were built onsite.

For example, a 100-unit market rate for sale development would normally provide 15 BMR moderate income units at the proposed income targets and proposed BMR requirements. If the developer determined that it is infeasible to provide those units onsite, a one acre site is donated to the City, subject to its approval. A one acre site that is zoned at least 40 units to the acre would likely generate 30-40 units, 15 of which would be very low income. In exchange for the 15% very low income units, the developer would be entitled to a 20% density bonus rather than a 27.5% density bonus if the very low income units were built onsite.

RECOMMENDATION:

Allow developers to justify economic infeasibility based on submission of specific criteria to construct off site, and allow a land dedication option as described in California density bonus law as an alternative to offsite construction.

Both of these options require the offsite units to be constructed at the same time or before the market rate units. Given the difficulty in finding suitable residential sites, these options would be rarely used. However it does open up the possibility for market rate developers to joint venture with an affordable housing developer to leverage more units than the BMR requirements.

4. Flexibility in BMR Unit Design

Most of the current residential planning applications would be considered "high end" market rate housing. The finishes are upscale and the unit sizes are very large. For example, about half of the two bedroom units constructed over the past 10 years have been 1,400 square feet or larger. There are a number of recommendations that can decrease developer costs for BMR units in recognition of the proposed 15% BMR requirement, yet still obtain very livable and attractive units for the program.

Currently the program requires the BMR units to be no smaller than the smallest market rate unit offered by bedroom size. This works well in projects that have a variety of unit sizes. However in the situation that the market rate units are all very large, the BMR units are also large. Currently the program has about 40 two-bedroom units sized 1,200 square feet or larger. These units could still be considered spacious if they were 1,000-1,100 square feet. Therefore it is recommended to allow BMR units to be smaller than market units in these situations as long as minimum square footages are maintained to avoid inadequately sized BMR's.

RECOMMENDATION:

Allow smaller units by square footage but establish minimum sizes in relation to market rate units

Although single family detached residential development is rare in San Mateo, it is extremely expensive to provide "like" units for BMR's. At Bay Meadows, the City obtained single family units that were 1,600 to 1,900 square feet, and at Verona Ridge the units are scheduled to be 2,400-2,600 to match the other market rate homes per our current program guidelines. As mentioned above, the City could allow the BMR houses to be constructed smaller than the other units, but they may not be to scale with the rest of the development. Alternatives that other cities have used include:

- Allow BMR units to be provided in the form of duplexes in single family detached developments. These can be designed to have the appearance of single family units, but allow the construction cost efficiency of providing two smaller units. This is especially effective on corner lots, where the each unit can face a different street.
- In mixed-product projects, allow the single family obligation in the multifamily portion of project.

In cases that a project has a combination of single family units as well attached units such as townhouses, the City could allow the BMR's be included in the multifamily portion of the same project, as long as the substituted units have the same bedroom count as the single family units, and are architecturally compatible with the single family units.

RECOMMENDATION:

Allow flexibility of product type in single family detached projects as long as the exterior design is compatible.

Depending on housing needs at any point in time, the City may decide that a different bedroom mix may be a greater benefit to the program than the usual BMR formula as long as there is always a minimum 10% provided and the total bedroom count is obtained. For example if a 40 unit project is required to provide 6 BMR units under the new 15% requirement: one 3 BR unit, four 2 BR units and one 1 BR unit, (total 12 bedrooms) the City may agree to accept four 3 BR units instead if it determines there is a pressing need for large units. Conversely, the City may accept more units with smaller bedroom counts in an effort to maximize the number of units obtained.

In order to implement this option it is recommended that the City Council make an annual determination of need so developers know up front what options are available. This way the options can be revised as housing needs change over time.

RECOMMENDATION:

Allow different bedroom size distribution if the City determines it meets a need. At all times at least 10% must be provided and a minimum total bedroom count must be provided.

COMMERCIAL LINKAGE FEE

Another way to implement the Housing Strategy to increase funds to support affordable housing is the creation of a commercial linkage fee. Measure P includes language that asks the City Council to study and if possible adopt a fee that is charged to commercial development to support housing. After the passage of the original Measure H, the City did look at a fee, but due to the slump in commercial development at the time, decided not to impose what was viewed as a constraint to development. It was recommended that the concept be revisited at a later date.

A nexus study was prepared by Keyser Marsten Associates in February 2003. The City Council reviewed this topic at study sessions in 2003 and 2004 but took no action.

The rationale for a commercial linkage fee is that new commercial development increases the number of jobs in a community, which then puts additional pressure on the existing housing supply, causing housing costs to increase. The nexus study serves as a way to quantify the impact of commercial development on housing and to devise an impact fee to mitigate that pressure. The nexus study determined that a fee could be justified in the range of $20-25 per square foot. However, the recommended level of a fee was in the range of $5-10 per square foot. The report indicated that the increase in total development costs for such a fee would be 1.5% and 3% respectively, which would not significantly impact development activity. Since this study was completed in 2003, we asked EPS to review the study and determine whether the recommendations are still valid. Appendices E and F include the executive summary of the original report as well as the peer review by EPS. The conclusion by EPS is that the methodology and key assumptions of the Keyser Marsten study are still supportable and that updating the affordability gap and employment density would provide a nexus for a higher fee than the original study.

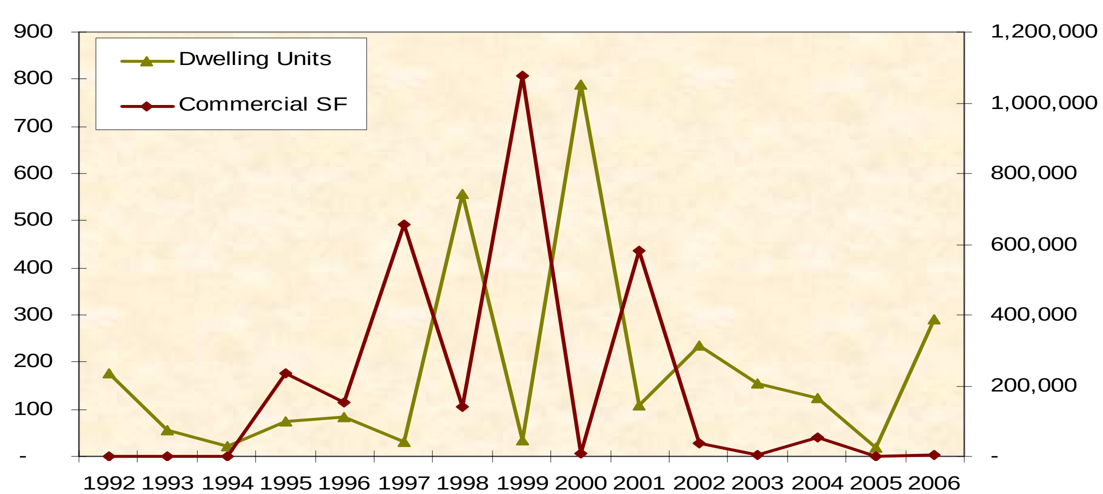
The attractiveness of the commercial linkage fee to the TAC at this time is twofold. First, the fee spreads the burden of the community's housing shortage. Currently, residential developers take on the sole burden of affordable housing through the BMR program, whereas commercial developers bear no financial responsibility even though their projects may exacerbate the demand for market-rate and affordable housing. The San Mateo County Housing Needs Study (2006) projects that between 2005 and 2025 the number of jobs countywide will increase 40%, therefore it is likely that new commercial space will be constructed to accommodate those jobs and create more demand for existing and additional housing stock.

Secondly, the commercial construction market is just coming out of the low part of a cycle that has produced little new construction due to an office space surplus from a few years ago. In 1993, the Council decided the commercial market was too flat to implement a linkage fee. However, since that time new commercial development totaled approximately 3 million square feet and could have provided about $15 million if a $5 fee had been in place. Even in the recent relatively flat commercial market conditions, $3.4 million could have been collected since the year 2000. Figure 18 below identifies the type and amount of new commercial space constructed from 1993 to the present. Since a similar flat market exists today, a fee instituted now would reap the benefits when commercial construction resumes.

Figure 18
Non-Residential Building Permit Activity 1993-2006
(Square Feet Constructed)

Year	Office	Retail	Hotel	Total
1993				0
1994				0
1995	233,919	3,151		237,070
1996		152,128		152,128
1997	101,715	552,331		654,046
1998	23,773	115,074		138,847
1999	980,905		97,000	1,077,905
2000	85,000			85,000
2001	492,334		89,198	581,532
2002		36,880		36,880
2003		5,832		5,832
2004	52,690			52,690
2005				0
2006		3,200		3,200
Total	1,970,336	868,596	186,198	3,025,130

Figure 19
Commercial and Residential Permits
1992-2006



Another consideration for a commercial linkage fee is that often the commercial and residential development cycles fall at opposite times. Figure 19 adds the permits for residential units to the commercial permits outlined in Figure 18 as a graph to demonstrate historical construction activity since the adoption of Measure H. A fee that is captured at the time of commercial development can help provide funds for affordable housing units during the lull periods of residential development to ensure a more continuous supply of assistance for affordable housing.

The TAC discussed several issues concerning the imposition of a new fee. A survey of the Bay Area shows that fees are often structured differently for different types of development. The cities located closest to San Mateo that have commercial linkage fees include Menlo Park, Palo Alto, Mountain View and Sunnyvale. The fees for office space for these cities range from $3 to $16 per square foot. The Bay Area average is about $5 per square foot. A detailed survey of Bay Area cities is included in Appendix G.

Some members of the TAC expressed concerns that a new fee would hinder the development of commercial property, which is parallel to the concerns on raising the BMR requirement on residential development. EPS had conducted some analysis of these economic impacts for a similar commercial linkage fee study for Sonoma County. That study concluded that Bay Area jurisdictions that adopted commercial linkage fees attracted similar levels of commercial development before and after implementation of the fees, suggesting that no negative impact was realized. One reason for this is that the costs of such fees, when known early enough in the development process, can be reflected in the price a developer is willing to pay for land, and thus does not require higher rents or other premiums that may keep tenants from choosing the implementing city as their location.

As suggested by the Keyser Marsten study, a commercial linkage fee may also be a relatively minor addition to the overall costs of development, and thus not a major deterrent to new construction. Figure 20 compares the existing San Mateo development fees on similarly sized residential and commercial projects. These are based on actual projects that were built about five years ago, but updated to today's fees, since there are no current commercial projects to use for comparison purposes. This chart quantifies the BMR requirement as a fee to compare total costs to the developer imposed by the City and assumes a commercial linkage fee of $5 per square foot.

There are some fees that are not applied to both commercial and residential development. The two most substantial costs for residential developments are the Parks In-Lieu Fee and the BMR requirement, which are not imposed on commercial projects. Commercial projects are required to pay a Childcare In-Lieu Fee, while residential projects do not. The basic City development and impact fees on both commercial and residential projects is generally 2-3% of the total development costs of the projects if one does not count the BMR inclusionary requirements. When the current 10% BMR requirement is quantified as a cost, it adds another 5% for a total of about 7-8% of total developer costs for residential projects. The addition of a commercial linkage fee in the amount of $5 per square foot increases City imposed fees for commercial properties an additional 1% of development costs for a total of about 3%, compared to the total average of 7-8% for residential under current program conditions.

Figure 20
Sample Development Fees

(Based on actual projects built 2001-2002 with fees updated to 2007 levels)

	Office	Residential 218 Units	Hotel	Residential 44 Units
Size (sq. ft.)	205,000	230,000	52,000	48,000
Impact Fees:				
Wastewater Treatment	36,000	110,000	28,000	25,000
Transportation Impact	804,000	417,000	162,000	66,000
Park in lieu Fee	NA	881,000	NA	583,000
Childcare 2004	205,000	NA	52,000	NA
Art in Public Places 2005	77,000	117,000	20,000	24,000
Total	1,045,000	1,638,000	242,000	722,000
Development Fees:				
Planning Fees	167,000	163,000	38,000	62,000
Building Permits	460,000	460,000	95,000	102,000
Pub Works Fees	90,000	264,000	60,000	88,000
Total	717,000	887,000	193,000	252,000
Total City Fees	**1,762,000**	**2,525,000**	**435,000**	**974,000**
Est. Development Cost (including land)*	**85,075,000**	**140,300,000**	**21,580,000**	**29,280,000**
Fees as % of Costs	2.1%	1.8%	2.0%	3.3%
Inclusionary Housing Costs:				
Cost of BMR @10%		7,700,000		1,400,000
Commercial Linkage Fee @$5	1,025,000		260,000	
Fees as % of Costs	1.2%	5.5%	1.2%	4.8%
Grand Total Developer Impacts:	**2,787,000**	**10,225,000**	**695,000**	**2,374,000**
Fees as % of Costs	3.3%	7.3%	3.2%	8.1%

* $415 SF commercial, $610 SF residential, sources: Keyser Marsten, EPS

This chart does not take into account proposed changes in City development fees or the proposed increase in BMR requirements. Since the City is currently studying other new or increased development fees, care should be taken to look at the cumulative impact. Also there are several parameters that can be designed into a fee such as reducing or exempting certain types of developments that are more sensitive to these fees such as retail, or projects under a certain physical size. Staff recommends that a fee of $5 per square foot be used as a starting point for evaluation. This can be modified upon the comprehensive fee study that will be reviewed in preparation of the next fiscal year's budget. The TAC also recommended that if the City adopts a commercial linkage fee, the ~~a~~ fee should be implemented a year or so after its approval in order to give developers time to adjust their costs assumptions well in advance of project approvals.

RECOMMENDATION:

Adopt a commercial linkage fee of $5 per square foot on new commercial developments subject to revision after taking into consideration other new development fees imposed by the City.