Attachment 6

The Economics of Land Use

Draft Report

Rental Inclusionary Housing In-Lieu Fee

Prepared for:

City of Foster City

Prepared by:

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Executive Summary

Economic & Planning Systems, Inc. (EPS) was hired by the City of Foster City to create new affordable housing fees, including the inclusionary housing in-lieu fee. The City is currently considering a Citywide inclusionary housing ordinance under which 20 percent of units in a rental project would be required to be offered at below-market-rate prices affordable to "very low," "low," and "moderate" income households based on income standards established by the State of California's Department of Housing and Community Development (HCD). The City is also exploring the potential to offer an alternative inclusionary requirement in a specified "overlay zone," in which 15 percent of units would be required to be affordable at "extremely low," "very low," and "low" income levels.

Table 1, below, shows the in-lieu fee calculation results under these two scenarios. As detailed later in this document, the in-lieu fees are based on the aggregate subsidy required to produce the number of affordable units prescribed under each scenario that the City wants to explore for its inclusionary housing ordinance (a "Citywide" standard for 20 affordable units out of each 100 total units in a project, and 15 affordable units out of each 100 total units in a project representing an overlay zone). As shown, the fee associated with the 20 percent inclusionary requirement (very low, low, and moderate income) is calculated to be $75,316 per market-rate unit or $75.32 per square foot of the market-rate units, while the fee associated with the 15 percent inclusionary requirement of the overlay zone (extremely low, very low, and low income) is calculated to be $68,264 or $68.26 per square foot. Adopting fees at these levels would represent the true costs of the City's inclusionary housing ordinance, as the calculations are based on the costs versus values of units meeting the inclusionary ordinance. As such, fees at this level would represent a generally "cost-neutral" option to developers relative to producing inclusionary units within their projects.

Table 1 Summary of In-Lieu Fees for Rental Housing

Inclusionary Requirement	Fee per Market-Rate Unit	Fee per Square Foot [1]
Citywide Scenario *(10% Very Low; 5% at Low; and 5% Moderate)*	**$75,316**	**$75.32**
Overlay Zone Scenario *(4% Extremely Low; 4% Very Low; and 7% Low)*	**$68,264**	**$68.26**

[1] Consistent with the affordability gap analysis, an average net unit size is 1,000 square feet is assumed. This area is the average unit size of two bedroom units developed in Foster City recently.

Source: Economic & Planning Systems, Inc.

Methodology

Through an affordability gap analysis, this report estimates the subsidy needed to produce rental housing that is affordable to households at specified income levels in the event that developers do not build the units themselves. EPS calculates the in-lieu fee based on the two scenarios for rental housing developments, one which is citywide and the other that is for an overlay zone:

1) Citywide: Providing 10 percent of the units to very low-income households, 5 percent to low-income households, and 5 percent to moderate-income, for a total of 20 percent inclusionary units.
2) Overlay Zone: Providing 4 percent of the units to extremely low-income, 4 percent to very low-income households, and 7 percent to low income, for a total of 15 percent inclusionary units.

Maximum Affordable Housing Rents

The income levels are set for the County of San Mateo by the California Department of Housing and Community Development (HCD) on an annual basis. **Table 2** shows the income limits for 2021, which vary by the number of people in the household. The average household in Foster City has 2.66 people according to 2019 Five-Year Estimates from the American Community Survey (ACS). Thus, **Table 2** illustrates the income limits for a three-person household, to represent the City's average household size (rounded). The Area Median Income (AMI) for a family of three in San Mateo County is $134,650 in 2021 as shown below. Please note that the nominal income categories do not necessarily correspond mathematically to the figures set by HCD; for example, "low" income is nominally meant to represent households earning up to 80 percent of median income, but in San Mateo County the maximum income allowed by HCD in this category is nearly 100 percent of median income.

Table 2 San Mateo County's 2021 Income Limits for 3-Person Households

Income Group and Definition		**2021 Maximum Income** 3-Person Household
Extremely Low	≤30% AMI	$49,350
Very Low	>30% to ≤50% AMI	$82,250
Low	>50% to ≤80% AMI	$131,750
Median (Base)	>80% to ≤100% AMI	$134,650
Moderate	>100% AMI to ≤120% AMI	$161,550

Source: San Mateo County 2021 Income Limits, California Department Housing and Community Development (HCD).

Consistent with HCD guidelines and direction from City staff, EPS has assumed a three-person household would reside in a two-bedroom unit, and that the households spend 30 percent of their gross annual income on housing costs, including rent and utilities. Then the annual spending on utilities is subtracted from the annual spending on housing to determine the maximum rent that a household can pay, as summarized on **Table 3** below.

A moderate-income household at 110 percent of median income in a three-bedroom unit can pay up to $3,420 on monthly rent, while a low-income household at 80 percent of median income can pay up to $3,011, a very-low-income household can pay $1,773, and an extremely-low-income household can pay only $951. As shown, EPS estimates that a newly constructed market-rate unit of the same size could achieve monthly rent of $4,250, so each of the affordable rent levels represents a significant discount from current market rates.

Table 3 2021 Maximum Supported Rents by Income Category

Income Category	AMI	Annual HH Income (3-Person)	Annual Spending on Housing [1]	Annual Spending on Utilities [2]	Max Rent Assumptions	
					Annual Rent	*Monthly Rent*
Extremely Low	30%	$49,350	$14,805	$3,396	$11,409	$951
Very Low	50%	$82,250	$24,675	$3,396	$21,279	$1,773
Low	80%	$131,750	$39,525	$3,396	$36,129	$3,011
Moderate	110%	$148,100	$44,430	$3,396	$41,034	$3,420
Market						$4,250

[1] Assumes a housing costs to income ratio of 30 percent. Includes rent plus utilities.
[2] Assumes annual utility expenditures consistent with the San Mateo County limits for a 2-bedroom unit (assumes use of electricity for heating and cooking). Utility costs effective March 2021.

Source: San Mateo County 2021 Income Limits; San Mateo County Utility Allowance Schedule; and Economic & Planning Systems, Inc.

Affordability Gap Analysis

Product Type

The analysis assumes that the collected in-lieu fees would be used to subsidize the production of lower-income units similar to the type of multifamily construction currently observed in the City. The assumed prototype reflects multifamily construction at 35 dwelling units to the acre with surface parking. Though projects vary, City staff has confirmed that this product type is representative of multifamily housing developments that are being built in the City and the surrounding region.

California State law (California Health and Safety Code Section 50052.5) assumes that a 2-bedroom unit is occupied by a 3-person household, and this assumption is used in this analysis. Consistent with input from the City, EPS assumes that the typical net square footage of a 2-bedroom rental unit in Foster City will be approximately 1,000 square feet. Applying a "load factor" of 15 percent to account for shared lobbies, hallways, etc., results in gross square footage of 1,150 square feet per unit.

Development Cost Assumptions

Affordable housing development costs include land costs, direct costs (e.g., labor and materials), and indirect or "soft" costs (e.g., architecture, entitlement, marketing, etc.). Data from recent land transactions in and around Foster City have been combined with EPS's information from various market-rate and affordable housing developers on the Peninsula to estimate appropriate development cost assumptions for use in Foster City. A developer fee is also estimated, and represents the compensation to the developer for their efforts, investment, and risk. These assumptions are shown on **Table 4** and indicate that the total cost per unit for rental apartments is about $848,000. By necessity, this figure represents a "prototypical" project; the actual costs for a given project will vary by location and project design characteristics.

Revenue Assumptions

To calculate the values of the affordable units, assumptions must be made regarding the applicable income level and the rents paid based on an appropriate percentage of household income spent on housing costs. In addition, translating these assumptions into unit prices and values requires estimates of operating expenses and capitalization rates. The following assumptions were used in these calculations:

- *Income Levels*—This analysis estimates the subsidy required to produce units for three-person households at HCD-defined income levels as shown in **Table 2**. In keeping with the City's expressed interest for the "Citywide" and "overlay" scenarios, EPS has used income levels ranging from 30 percent of median ("extremely low income") to 110 percent of median ("moderate income") and points between.
- *Percentage of Gross Household Income Available for Housing Costs*—HCD standards on overpaying for rent indicate that households should pay no more than 30 percent of their gross income on housing costs. As previously shown on **Table 3**, EPS calculated the rents that each income category would be able to pay, after subtracting the households' monthly expenses for utilities.

- *Operating Costs for Rental Units*—This analysis assumes that affordable apartment operators incur annual operating costs of $9,000 per unit, which include the cost of management, maintenance, and common utilities (those not paid by tenants) for units that are for households earning up to 80 percent of AMI. These operating costs assumes that all affordable apartments constructed would be exempt from property taxes because they are income-restricted and constructed by non-profit developers. Units that are for moderate-income households are assumed to incur an annual operating cost of 30 percent of annual gross rent revenue, and are not exempt from property taxes.

Affordability Gap Results

Table 4 shows the subsidies required for construction of rental apartments for three-person households at defined moderate -, low-, very low-, and extremely low-income levels. As shown, such units are estimated to cost nearly $850,000 to develop, and the operating income from those units at affordable rents would translate to values well below those development costs. As such, a unit affordable to a moderate income household is expected to require a subsidy of roughly $188,500, while a unit for a low income household requires a subsidy of $199,000, a unit for a very low income household requires a subsidy of $559,000 and a unit for an extremely low income household requires a subsidy of $798,500.

Table 4 Affordability Gap Analysis

	Mid-Density Multifamily Apartments with Surface/Deck Parking			
	Extremely Low Income (30% AMI)	Very Low Income (50% AMI)	Low Income (80% AMI)	Moderate Income (110% AMI)
Development Program Assumptions				
Density/Acre	35	35	35	35
Gross Unit Size [1]	1,150	1,150	1,150	1,150
Net Unit Size	1,000	1,000	1,000	1,000
Number of Bedrooms	2	2	2	2
Number of Persons per 2-Bedroom Unit [2]	3	3	3	3
Parking Spaces/Unit	2.25	2.25	2.25	2.25
Cost Assumptions				
Land/Acre [3]	$7,837,315	$7,837,315	$7,837,315	$7,837,315
Land/Unit	$223,923	$223,923	$223,923	$223,923
Direct Costs				
Direct Construction Costs/Gross SF [4]	$325	$325	$325	$325
Direct Construction Costs/Unit	$373,750	$373,750	$373,750	$373,750
Parking Construction Costs/Space	$5,000	$5,000	$5,000	$5,000
Parking Construction Costs/Unit	$11,250	$11,250	$11,250	$11,250
Subtotal, Direct Costs/Unit	$385,000	$385,000	$385,000	$385,000
Indirect Costs as a % of Direct Costs [5]	35%	35%	35%	35%
Indirect Costs/Unit	$134,750	$134,750	$134,750	$134,750
Developer Fee (% of all costs)	14%	14%	14%	14%
Developer Fee	$104,114	$104,114	$104,114	$104,114
Cost w/o Developer Fee	$743,673	$743,673	$743,673	$743,673
Total Cost/Unit	$847,788	$847,788	$847,788	$847,788
Maximum Supported Home Price				
Household Income [6]	$49,350	$82,250	$131,750	$148,100
Revenue to Property Owner/Year [7]	$11,409	$21,279	$36,129	$41,034
(less) Op. Exp. Losses per Unit/Year	($9,000)	($9,000)	($9,000)	($13,329)
(less) Vacancy Losses per Unit/Year	($444)	($740)	($1,186)	($1,333)
Net Operating Income	$1,965	$11,539	$25,943	$26,372
Capitalization Rate	4.0%	4.0%	4.0%	4.0%
Total Supportable Unit Value [8]	$49,121	$288,469	$648,581	$659,303
Affordability Gap	($798,666)	($559,319)	($199,206)	($188,485)

[1] A load factor of 15% is applied to the net unit size to calculate the gross unit size.

[2] For this analysis, EPS has assumed an average unit for income-qualified worker households would be 2-bedrooms. State law (Health and Safety Code Section 50052.5) indicates that a 2-bedroom unit should be assumed to be occupied by a 3-person household.

[3] Based on CoStar reported land sale transactions in Foster City.

[4] Includes costs for contingency and site improvement.

[5] Includes costs for architecture and engineering; entitlement and fees; project management; appraisal and market study; marketing, commissions, and general administration; financing and charges; and insurance. These cost estimates are consistent with those used by housing developers in the San Francisco Bay Area.

[6] Based on 2021 income limits for a three-person household in San Mateo County established by HCD.

[7] Assumes housing costs (e.g., rent and utilities) to be 30% of gross household income.

[8] The total supportable unit value is determined by dividing the net operating income by the capitalization rate, provided by

Source: CoStar; California Department Housing and Community Development; Economic & Planning Systems, Inc.

In-Lieu Fee Calculations

Tables 5 and 6 translate these subsidies into in-lieu fees. In **Table 5**, the Citywide Scenario, a prototypical 100-unit rental project would be required to provide fees sufficient to subsidize ten very-low-income units, five low-income units, and five moderate-income units, which would jointly cost nearly $17 million to build but would be worth less than $10 million. The difference, of about $7.5 million, representing the subsidy that the 100-unit market-rate project would need to provide via in-lieu fees, translating to a fee of $75.32 per market-rate square foot.

Table 5 In-Lieu Fee Calculation – Citywide Scenario

	Income Level				In-Lieu Fee		
Item	*Very Low (50% AMI)*	*Low (80) (80% AMI)*	*Moderate (110) (110% AMI)*	***Total***	*per Affordable Unit*	*per Market-Rate Unit*	*per Market-Rate Square-foot [1]*
Units	10	5	5	20	20	100	
Value/Unit	$288,469	$648,581	$659,303				
Total Value	$2,884,688	$3,242,906	$3,296,513	$9,424,106			
Costs/Unit	$847,788	$847,788	$847,788				
Total Costs	$8,477,876	$4,238,938	$4,238,938	$16,955,751			
Subsidy per Unit	$559,319	$199,206	$188,485				
Total Subsidy Required	$5,593,188	$996,032	$942,425	$7,531,645	***$376,582***	***$75,316***	***$75.32***

[1] Consistent with the affordability gap analysis, an average net unit size is 1,000 square feet is assumed. This area is the average unit size of two bedroom units developed in Foster City recently.

Source: CoStar; San Mateo County; Economic & Planning Systems, Inc.

Similarly, in the second scenario, which is for the housing overlay zone, shown on **Table 6**, a prototypical 100-unit project would be required to provide fees sufficient to subsidize four extremely-low-income units, four very-low-income units, and seven low-income units, which would jointly cost $12.7 million to build but would only be worth $5.9 million total. The difference, $6.8 million, represents the subsidy that the 100-unit market-rate project would need to provide via in-lieu fees, translating to a fee of $68.26 per market-rate square-foot.

Table 6 In-Lieu Fee Calculation – Overlay Zone Scenario

Item	Income Level			Total	In-Lieu Fee		
	Extremely Low (30% AMI)	*Very Low (50% AMI)*	*Low (80) (80% AMI)*		*per Affordable Unit*	*per Market-Rate Unit*	*per Market-Rate Square-foot [1]*
Units	4	4	7	15	15	100	
Value/Unit	$49,121	$288,469	$648,581				
Total Value	$196,485	$1,153,875	$4,540,069	$5,890,429			
Costs/Unit	$847,788	$847,788	$847,788				
Total Costs	$3,391,150	$3,391,150	$5,934,513	$12,716,813			
Subsidy per Unit	$798,666	$559,319	$199,206				
Total Subsidy Required	$3,194,665	$2,237,275	$1,394,444	$6,826,385	***$455,092***	***$68,264***	***$68.26***

[1] Consistent with the affordability gap analysis, an average net unit size is 1,000 square feet is assumed. This area is the average unit size of two bedroom units developed in Foster City recently.

Source: CoStar; San Mateo County; Economic & Planning Systems, Inc.