



SAN FRANCISCO PLANNING DEPARTMENT

Informational Memorandum

Project Name: Inclusionary Housing Working Group:
Preliminary Report September 2016

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Hearing Date: October 27, 2016

Recommendation: **Informational discussion only, no action required**

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OVERVIEW

The Planning Commission requested a public hearing on the Inclusionary Housing Working Group: Preliminary Report September 2016. No action is requested of the Planning Commission today. Staff will relay the Commission's discussion at this hearing to the Controller.

In June of 2016, San Francisco voters passed Proposition C, a Charter Amendment which made significant changes to the City's established Inclusionary Housing program. In an associated measure [BF 160255], the Board of Supervisors charged the Controller's Office with preparing a study of the economic feasibility of increased inclusionary housing requirements with advice from a newly established Inclusionary Housing Technical Advisory Committee (TAC).

The TAC provides input to the Controller, the Mayor, the Planning Department and the Board of Supervisors regarding the content of the Economic Feasibility Analysis report. The TAC consists of eight members, four appointed by the Board of Supervisors and four appointed by the Mayor. All members have experience and expertise in development finance. The TAC met with City Staff and the Controller's consulting team at four meetings during the summer of 2016. The Controller's Office commissioned three consulting firms to engage in different research tasks in support of these objectives.

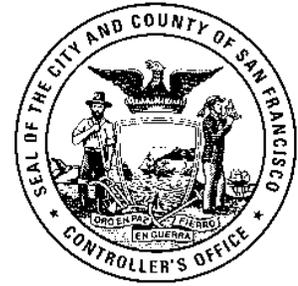
The attached report concludes the first phase of the Study. It discusses five recommended policy actions, and three areas for further research. The Controller's Office and its consultants plan to research and report on these issues in a follow-up addendum to this report.

Five Policy Recommendations

1. The City should impose different inclusionary housing requirements on rental and for-sale (condominium) properties.
2. The City should set the initial onsite requirements from 14%-18% for rental projects and 17%-20% for ownership projects.
3. The City should commit to a 15-year schedule of increases to the inclusionary housing rate of 0.5% per year.
4. The City should conduct a new analysis to update the schedule of fees.
5. The City should impose additional affordability requirements for any 80/20 project financed through the City's financing approval process.

Areas for Additional Consideration and Study

1. State Density Bonus
2. Income Limits
3. When in the Development Process Should Inclusionary Requirements be Set?



Inclusionary Housing Working Group: Preliminary Report September 2016

Office of the Controller

Consulting Team:

- Blue Sky Consulting Group
- Century Urban LLC
- Street Level Advisors

9/13/2016

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Summary: Background and Recommendations

<p><i>Proposition C and the Rationale for this Study</i></p>	<p>In June of 2016, San Francisco voters passed Proposition C, a Charter Amendment which made significant changes to the City’s established Inclusionary Housing program.</p> <p>Following the passage of the measure, the Board of Supervisors charged the Controller’s Office with preparing a study of the economic feasibility of increased inclusionary housing requirements. To advise on these recommendations, the Controller’s Office also convened a Technical Advisory Committee (TAC), with representatives appointed by the Mayor and Board of Supervisors.</p> <p>The TAC met with Controller Staff and its consulting team at four meetings during the summer of 2016. TAC members include:</p> <ul style="list-style-type: none">• Dan Adams, Bridge Housing• Jesse Blout, Strada• Terence Cordero, Wells Fargo• John Elberling, TODCO• Emily Johnstone, Housing Investment Trust• Whitney Jones, Chinatown CDC• Lydia Tan, Bentall Kennedy• Eric Tao, AGI Avant <p>As detailed in the conclusion, each of this report's recommendations were approved by the TAC at its most recent meeting on September 7, 2016.</p>
<p><i>Outline of this Report</i></p>	<p>The Controller's Office commissioned three consulting firms to engage in different research tasks in support of these objectives:</p> <ul style="list-style-type: none">• Blue Sky Consulting Group developed a housing simulation model that estimated how overall market-rate and affordable housing production would change in the city, given different inclusionary requirements.• Century Urban LLC conducted field research and scenario analysis reviewing how various inclusionary housing provisions would affect residual land value of four project prototypes, as well as research into prevailing land prices in San Francisco. The firm played a role with the Housing Working Group, and their work in this effort is a continuation of that field research and scenario analysis.• Street Level Advisors studied how other cities have approached the design of their inclusionary housing programs. <p>This report is based on the research of the three consulting firms, and</p>

	<p>concludes with a discussion of five recommended policy actions, and three areas for further research.</p> <p>The Controller's Office and its consultants plan to research and report on these issues in a follow-up addendum to this report.</p>
<p><i>Recommendations</i></p>	<p>Based on the analysis and research of the consulting team, the Controller's Office developed several policy recommendations and vetted them with the TAC at a meeting on September 7, 2016. The recommendations, and the TAC's opinion on each of them, are detailed below.</p> <ol style="list-style-type: none"> 1. The City should impose different inclusionary housing requirements on rental and for-sale (condominium) properties. <p>The TAC endorsed this recommendation unanimously.</p> <ol style="list-style-type: none"> 2. The City should set the initial onsite requirements from 14%-18% for rental projects and 17%-20% for ownership projects. <p>The TAC endorsed this recommended range unanimously. TAC member differed on what they felt the specific initial requirements should be, within this range.</p> <ol style="list-style-type: none"> 3. The City should commit to a 15-year schedule of increases to the inclusionary housing rate of 0.5% per year. <p>The TAC unanimously endorsed the recommendations of a 15-year phase-in of higher requirements, with a study every five years.</p> <p>With respect to the rate of increase, six TAC members supported the 0.5% annual increase recommendation, and two members felt the annual increase should be higher, in the range of 0.75% - 1.0% per year.</p> <ol style="list-style-type: none"> 4. The City should conduct a new analysis to update the schedule of fees. <p>The TAC endorsed this recommendation unanimously.</p> <ol style="list-style-type: none"> 5. The City should impose additional affordability requirements for any 80/20 project financed through the City's financing approval process. <p>The TAC endorsed this recommendation unanimously.</p>

Prototype Scenario Analysis

<p><i>Economics of Inclusionary Housing</i></p>	<p>By requiring market rate housing developments to include a certain number of units for low and moderate income residents, inclusionary housing has the potential to increase the supply of affordable housing in San Francisco. However, providing these below market rate (BMR) units also results in increased costs for developers (or reduced revenue from development projects). The economic effects of the policy, however, can be very different depending on who ends up bearing its costs .</p> <p>From an economic standpoint, the question of who actually bears the burden of higher development costs is not straightforward. While there are different models for development of residential housing, most projects are conceived and managed by developers who hire architects and contractors to build the projects using financing provided by outside investors. Because these investors have many investment opportunities elsewhere in the capital markets, policies and economic factors that reduce the return on investing in housing tend to reduce the capital available and therefore the extent of residential housing development.</p> <p>Developers and their equity investors, therefore, do not ultimately pay the higher costs themselves. In most cases, increased costs for development (such as a higher inclusionary requirement) will either be passed on to land owners by developers, or result in reductions in the extent of residential development.</p> <p>The impact of a higher inclusionary requirement therefore depends, to a large degree, on the extent to which developers can pass on the added costs of the policy to land owners in the form of lower offers for the land on which housing developments can be constructed. If land owners have limited options for alternative development (such as hotel or office uses) or if the existing use is not very profitable, land owners may be inclined to accept a lower offer from a developer for their land. In these cases, the cost of the inclusionary policy is passed on to land owners.</p> <p>However, if land owners choose not to sell their land to housing developers at the lower offering prices that result from increased inclusionary requirements, the overall supply of available land for residential development will diminish, and with it the supply of housing units. Since the inclusionary policy does not change the demand for market rate units, the reduced supply of housing will tend to push up prices relative to what would otherwise be the case. To the extent this occurs, consumers seeking housing would ultimately pay for the higher development costs.</p>
<p><i>Process and Background</i></p>	<p>The most common method used by cities to assess the potential impact of exactions and fees on new housing development is by studying how higher costs affect the overall cost of development for certain sample projects</p>

(called "prototypes"). This approach builds on the idea that developers cannot pass their higher costs directly on to consumers, so an increased fee or exaction leads to a reduction in the *residual land value*—the amount a development project can afford to bid for land (often expressed per unit of new housing).

The approach does not quantify how much a fee can rise, and residual land value can decline, before a project is no longer feasible. However, by comparing the residual land values that would result from a proposed inclusionary policy with actual historical land values, it is possible to make more informed judgments about the proposed policy's risk to project feasibility.

To explore how changes in the City's inclusionary requirements might affect residual land value, the consulting team first conducted research regarding historical land sales comparable data in the City to study the change in land sales prices per unit over time for both entitled and unentitled land. The results of this research were presented at the July 21, 2016 Inclusionary Technical Advisory Committee ("TAC") meeting and are summarized below.

The consulting team also prepared four programmatic options or prototypes for multifamily for-rent apartments and four programmatic options or prototypes for multifamily for-sale condominiums. These prototypes reflect three construction typologies (two of the four prototypes are variants of one construction typology) as relative data points for review and consideration. The prototypes are intended to reflect new construction of institutional quality residential product.

Three of these prototypes – Type Ia (highrise), Type III (midrise), and Type V (lowrise) – were established with assistance from the San Francisco Planning Department, the San Francisco Mayor's Office of Housing & Community Development, and the San Francisco Office of Economic & Workforce Development, as well as from attendees of open Housing Working Group meetings, as part of preliminary field research and scenario analyses work completed in February 2016. A fourth prototype - Type Ib (a larger highrise) was added in response to feedback provided by the TAC at its June 30, 2016 meeting, where a prototype with a height greater than 240 feet was requested.

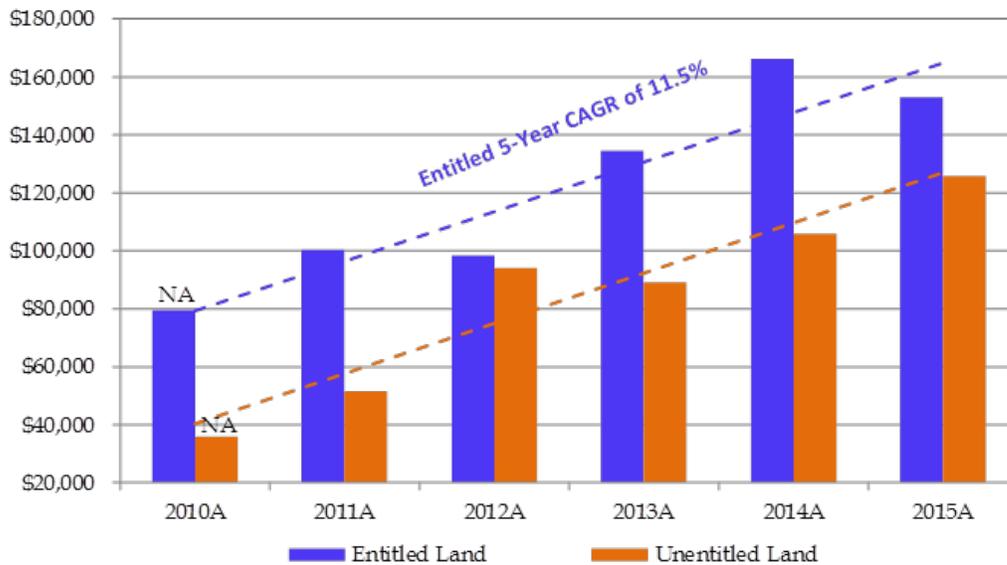
As part of the preliminary field research and scenario analyses work completed in February 2016, preliminary underwriting assumptions were presented to the Housing Work Group on January 29, 2016 to gather consensus and address questions, and a follow-up review and discussion of preliminary analytical results with the Housing Working Group occurred on February 3, 2016. Additionally, the TAC provided input regarding the preliminary field research and scenario analyses assumptions and methodology at its June 30, 2016 meeting. This feedback was incorporated into the updated preliminary analytical results, which were presented at the

August 22, 2016 TAC meeting.

*Land Sale
Comparable Analysis*

Land sales comparable data was gathered for select land sale transactions from 2010 to 2015. This data was analyzed to study land sales prices per unit by year for entitled and unentitled land. As shown in the chart and table below, the land sales price per unit for entitled land increased from approximately \$80,000 in 2010 to \$163,000 in 2015 and for unentitled land from approximately \$36,000 in 2010 to \$126,000 in 2015. This resulted in an estimated compounded annual growth rate of 11.5% for land sales prices per unit for entitled land.

SAN FRANCISCO LAND PRICE PER UNIT - ENTITLED VS. UNENTITLED (a)



Year	Entitled Land	Entitled Land Growth Rate	Unentitled Land
2010A	\$ 79,655	NA	\$ 36,075
2011A	\$ 100,510	26.2%	\$ 51,423
2012A	\$ 98,283	(2.2%)	\$ 93,968
2013A	\$ 134,430	36.8%	\$ 89,013
2014A	\$ 166,256	23.7%	\$ 105,993
2015A	\$ 152,944	(8.0%)	\$ 125,745

Notes:

*** Residential land sale data should be independently verified to extent that it may be relied upon. ***

(a) Select land sale data gathered from available public records, third party brokerage firms, and market research for residential development sites in City & County of San Francisco with projected unit count of approximately 50 units or greater.

*Approach and
Information Sources
for Scenario
Analyses*

This section refers to both prior and current field research from the consultants, conducted to estimate underwriting assumptions utilized to prepare the updated scenario analyses.

Scenario analyses were prepared for four prototypical forms of residential construction. With the exception of the Type Ib prototype, the prototypes had been previously reviewed and discussed with City agencies, and at Housing Working Group meetings to solicit feedback.

Residential unit mix and sizes for multifamily for-rent apartments and for-sale condominiums were determined based upon recently completed residential projects located within the City. The assumed unit mix and sizes are commensurate with recently completed projects and consistent with feedback gathered from interviews with project sponsors and provided at the January 29, 2016 Housing Working Group meeting.

Residential underwriting assumes a residential efficiency factor of 80% (excluding retail and parking components), with the exception of the Type Ib prototype, which assumes a residential efficiency factor of 78%. Retail space assumes a 90% retail efficiency factor. Parking ratios of 0.25:1 for apartments and 0.50:1 for condominiums are assumed for each prototype with parking provided at- and/or below-grade depending on the specific prototype.

Updated for-sale condominium comparable sales price data was obtained from Polaris Pacific and Vanguard Properties. Additional prior research regarding comparable sales data was conducted through The Mark Company and the San Francisco Association of Realtors. A review of data was utilized to determine estimated condominium sale prices for purposes of the scenario analyses and adjusted based upon construction typology.

Updated apartment rent comparables were obtained from third party multifamily apartment market research firms. Prior data was also provided by market rate project sponsors presently leasing market rate apartments. This information was utilized to estimate residential apartment rents for purposes of the scenario analyses and adjusted based upon construction typology.

The scenario analyses reflect currently approved City development impact fees. To the extent an impact fee has not been formally approved by the City, the fee is not included in the scenario analyses. The following development impact fees are included: Transportation Sustainability Fee, School Impact Fee, Jobs-Housing Linkage Fee, Wastewater Capacity Charge, and Water Capacity Charge. Impact fees that are unique to certain approved area plans are excluded from the scenario analyses.

General contracting firms listed below were contacted again and provided with the programmatic information for the prior and new prototypes in order to obtain informed construction cost estimates for each prototype. The general contracting firms contacted again include Swinerton Builders, Nibbi

	<p>Brothers, Pankow Builders, and Lend Lease Construction Company.</p> <p>Soft costs (e.g., architecture and engineering, financing, etc.) were reviewed and discussed with project sponsors and as part of the prior Housing Working Group meetings.</p> <p>Pursuant to feedback provided by the TAC at its June 30, 2016 meeting, the scenario analyses were revised to be untrended (i.e., no escalation is applied to revenues, expenses, or costs).</p> <p>The target return rate for for-rent apartments was adjusted to reflect untrended scenario analyses, based in part on input from the TAC and the consultant's ongoing monitoring of return rates required by project sponsors. The target going-in rate of return rate used in the analysis was 5.05%. This and all other assumptions about the scenario analysis are provided in the appendix. Due to the type of target return rate utilized for for-sale condominiums, an adjustment to this rate was not necessary. Additionally, target return rates were previously reviewed, discussed, and/or confirmed during the Housing Working Group meetings.</p>
<p><i>Scenario Analysis Results</i></p>	<p>Based on the approach and information obtained from the sources described above, scenario analyses for each for-rent apartment and for-sale condominium prototype were prepared for illustrative purposes to estimate the residual land values per unit for each prototype based on the following assumed on-site and in-lieu fee inclusionary requirements.</p>

On-Site Requirement	Description
12% - Pre Prop C	12% of total units at 55% of Area Median Income (AMI) for apartments and 12% at 90% of AMI for condominiums, which reflects on-site inclusionary requirement prior to Proposition C.
15% at 55%/90% AMI	15% of total units at 55% of Area Median Income (AMI) for apartments and 15% at 90% of AMI for condominiums.
12%	12% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.
14%	14% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.
16%	16% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.
18%	18% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.
20%	20% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.
25% - Prop C	25% of total units with 60% of on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums, which reflects interim on-site inclusionary requirements under Proposition C.

In-Lieu Fee Requirement	Description
20% - Pre Prop C	Payment of in-lieu fee based on 20% of total units, which reflects in-lieu fee inclusionary requirement prior to Proposition C.
23%	Payment of in-lieu fee based on 23% of total units.
25%	Payment of in-lieu fee based on 25% of total units.
28%	Payment of in-lieu fee based on 28% of total units.
30%	Payment of in-lieu fee based on 30% of total units.
33% - Prop C	Payment of in-lieu fee based on 33% of total units, which reflects interim in-lieu fee inclusionary requirement under Proposition C.

The resulting residual land values per unit for each inclusionary requirement listed above are summarized by prototype for apartments and condominiums in each of the tables below.

<i>Apartments</i>		Residual Land Value per Unit / % Reduction			
% Onsite Units		Type V	Type III	Type Ia	Type Ib
Building Type		Lowrise	Midrise	Highrise	Highrise
1.)	12% - Pre-Prop C [1]	\$124,000/ NA	\$126,800/ NA	\$91,000/ NA	\$112,700/ NA
2.)	15% at 55% AMI [2]	\$105,000/ NA	\$108,000/ NA	\$76,400/ NA	\$96,700/ NA

Mixed-Income Housing (55% & 100% AMI)

3.)	12.0% [3]	\$133,000/ NA	\$132,400/ NA	\$98,000/ NA	\$118,600/ NA
4.)	14.0% [3]	\$125,500/ (5.6%)	\$125,200/ (5.4%)	\$90,000/ (8.2%)	\$112,000/ (5.6%)
5.)	16.0% [3]	\$115,000/ (13.5%)	\$118,400/ (10.6%)	\$80,000/ (18.4%)	\$102,600/ (13.5%)
6.)	18.0% [3]	\$109,000/ (18.0%)	\$108,800/ (17.8%)	\$72,000/ (26.5%)	\$94,000/ (20.7%)
7.)	20.0% [3]	\$104,000/ (21.8%)	\$102,400/ (22.7%)	\$64,800/ (33.9%)	\$85,300/ (28.1%)
8.)	25% - Prop C [3]	\$78,000/ (41.4%)	\$80,000/ (39.6%)	\$43,600/ (55.5%)	\$62,600/ (47.2%)

<i>Apartments</i>		Residual Land Value per Unit / % Reduction			
% In-Lieu Fee		Type V	Type III	Type Ia	Type Ib
Building Type		Lowrise	Midrise	Highrise	Highrise
9.)	20% - Pre-Prop C	\$115,000/ NA	\$120,000/ NA	\$87,000/ NA	\$112,000/ NA
10.)	23.0%	\$101,000/ (12.2%)	\$111,200/ (7.3%)	\$77,000/ (11.5%)	\$102,600/ (8.4%)
11.)	25.0%	\$94,000/ (18.3%)	\$106,800/ (11.0%)	\$72,000/ (17.2%)	\$96,000/ (14.3%)
12.)	28.0%	\$91,500/ (20.4%)	\$96,800/ (19.3%)	\$63,000/ (27.6%)	\$87,300/ (22.1%)
13.)	30.0%	\$84,000/ (27.0%)	\$88,000/ (26.7%)	\$57,000/ (34.5%)	\$80,700/ (27.9%)
14.)	33% - Prop C	\$70,000/ (39.1%)	\$82,400/ (31.3%)	\$47,600/ (45.3%)	\$72,000/ (35.7%)

Notes:

- [1] Reflects 12% of total units at 55% of Area Median Income (AMI).
- [2] Reflects 15% of total units at 55% of Area Median Income (AMI).
- [3] Reflects 60% of total on-site affordable units at 55% of AMI and 40% at 100% of AMI.

Condominiums		Residual Land Value per Unit / % Reduction			
% Onsite Units		Type V	Type III	Type Ia	Type Ib
Building Type		Lowrise	Midrise	Highrise	Highrise
1.)	12% - Pre-Prop C [1]	\$147,000/ NA	\$131,000/ NA	\$134,000/ NA	\$133,000/ NA
2.)	15% at 90% AMI [2]	\$127,000/ NA	\$117,000/ NA	\$112,000/ NA	\$117,000/ NA

Mixed-Income Housing (80% & 120% AMI)

3.)	12.0% [3]	\$146,000/ NA	\$137,000/ NA	\$135,000/ NA	\$136,000/ NA
4.)	14.0% [3]	\$133,000/ (8.9%)	\$129,000/ (5.8%)	\$121,000/ (10.4%)	\$126,000/ (7.4%)
5.)	16.0% [3]	\$128,000/ (12.3%)	\$114,000/ (16.8%)	\$110,000/ (18.5%)	\$110,000/ (19.1%)
6.)	18.0% [3]	\$118,000/ (19.2%)	\$104,000/ (24.1%)	\$99,000/ (26.7%)	\$100,000/ (26.5%)
7.)	20.0% [3]	\$113,000/ (22.6%)	\$97,000/ (29.2%)	\$89,000/ (34.1%)	\$92,000/ (32.4%)
8.)	25% - Prop C [3]	\$92,000/ (37.0%)	\$63,000/ (54.0%)	\$56,000/ (58.5%)	\$60,000/ (55.9%)

Condominiums		Residual Land Value per Unit / % Reduction			
% In-Lieu Fee		Type V	Type III	Type Ia	Type Ib
Building Type		Lowrise	Midrise	Highrise	Highrise
9.)	20% - Pre-Prop C	\$122,000/ NA	\$131,000/ NA	\$134,000/ NA	\$133,000/ NA
10.)	23.0%	\$113,000/ (7.4%)	\$123,000/ (6.1%)	\$123,000/ (8.2%)	\$123,000/ (7.5%)
11.)	25.0%	\$103,000/ (15.6%)	\$114,000/ (13.0%)	\$117,000/ (12.7%)	\$116,000/ (12.8%)
12.)	28.0%	\$96,000/ (21.3%)	\$104,000/ (20.6%)	\$106,000/ (20.9%)	\$106,000/ (20.3%)
13.)	30.0%	\$87,000/ (28.7%)	\$97,000/ (26.0%)	\$101,000/ (24.6%)	\$100,000/ (24.8%)
14.)	33% - Prop C	\$72,000/ (41.0%)	\$89,000/ (32.1%)	\$89,000/ (33.6%)	\$90,000/ (32.3%)

Notes:

- [1] Reflects 12% of total units at 90% of Area Median Income (AMI).
- [2] Reflects 15% of total units at 90% of Area Median Income (AMI).
- [3] Reflects 60% of total on-site affordable units at 80% of AMI and 40% at 120% of AMI.

These residual land values per unit for each prototype were then weighted by the number of units of each prototype that could potentially be developed on soft sites within the City based on analysis of data obtained from the Planning Department. The resulting weighted average land values for for-rent apartments and for-sale condominiums were then further weighted by tenure based on an assumed distribution of potential units between apartments and condominiums of two-thirds apartments and one-third condominiums. The resulting weighted average residual land values per unit are summarized in the table below.

% Onsite Units			Residual Land Value per Unit		
			Apartments	Condominiums	Combined
			Weighted Average	Weighted Average	Weighted Average
1.)	12% - Pre-Prop C	[1]	\$119,500	\$140,400	\$126,400
2.)	15% at 55%/90% AMI	[2]	\$101,300	\$121,900	\$108,200
3.)	12.0%	[3]	\$127,100	\$141,600	\$132,000
4.)	14.0%	[3]	\$119,700	\$129,900	\$123,100
5.)	16.0%	[3]	\$110,200	\$120,800	\$113,800
6.)	18.0%	[3]	\$102,900	\$110,700	\$105,500
7.)	20.0%	[3]	\$97,000	\$104,300	\$99,400
8.)	25% - Prop C	[3]	\$72,700	\$77,800	\$74,400

% In-Lieu Fee			Residual Land Value per Unit		
			Apartments	Condominiums	Combined
			Weighted Average	Weighted Average	Weighted Average
9.)	20% - Pre-Prop C		\$112,300	\$126,600	\$117,100
10.)	23.0%		\$100,500	\$117,500	\$106,200
11.)	25.0%		\$94,400	\$108,500	\$99,100
12.)	28.0%		\$88,700	\$100,000	\$92,500
13.)	30.0%		\$81,200	\$92,300	\$84,900
14.)	33% - Prop C		\$70,200	\$79,700	\$73,400

Notes:

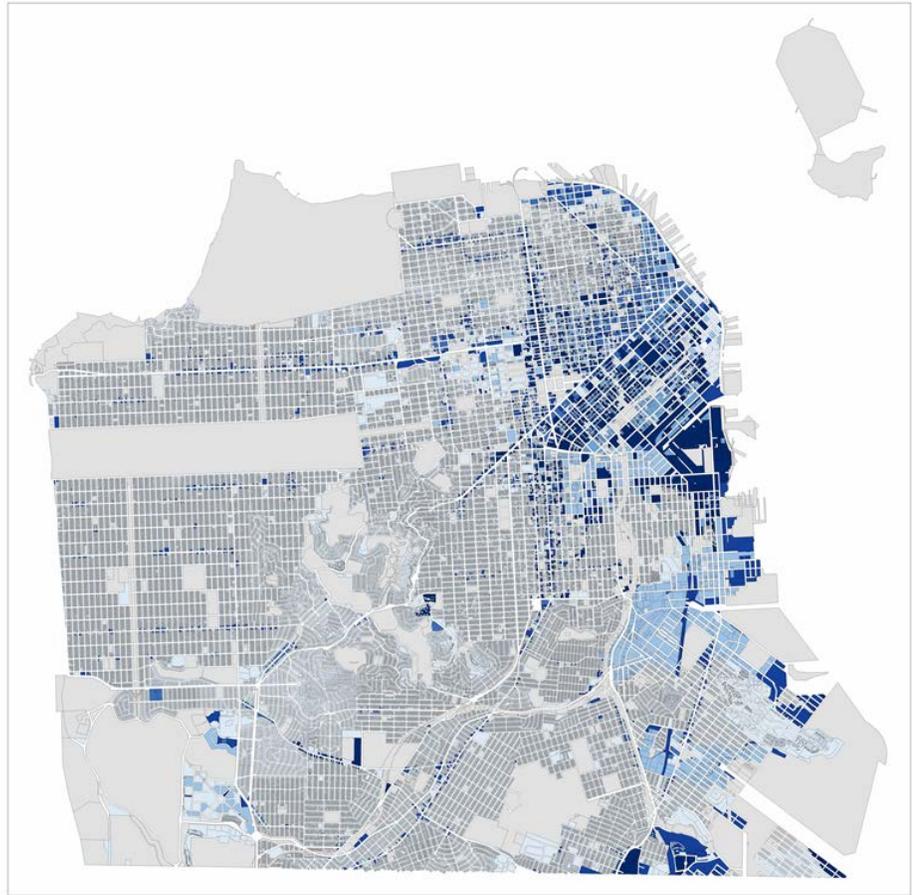
- [1] Reflects 12% of total units at 55% of Area Median Income (AMI) for apartments and 12% at 90% of AMI for condominiums.
 [2] Reflects 15% of total units at 55% of Area Median Income (AMI) for apartments and 15% at 90% of AMI for condominiums.
 [3] Reflects 60% of total on-site affordable units at 55% of AMI and 40% at 100% of AMI for apartments and 60% at 80% of AMI and 40% at 120% of AMI for condominiums.

With regard to evaluating land values for soft sites where potential development may occur based on the weighted average residual land values shown above, in areas where office and hotel uses are permissible, development of these soft sites for residential use may not be the economic highest and best use. Additionally, to the extent that certain soft sites are already occupied by existing buildings, the potential value of these sites as development sites may or may not exceed the value of the existing buildings on these sites.

Housing Simulation Modeling

<p><i>Measuring the Potential Impact</i></p>	<p>As discussed in the previous section, the prototype analysis brings real-world project costing information to the analysis of residual land value. It does not, however, draw bright lines regarding how much residual land value can decline before projects are no longer feasible. Nor can it generalize across all the development sites in the city, beyond the representative prototypes considered.</p> <p>In order to determine the potential impact on on city-wide housing development associated with a change in the inclusionary requirement, the consulting team conducted an analysis of the San Francisco housing market during the past 15 years. Specifically, the consulting team examined the relationship between housing prices and the extent of development of multifamily housing in the City while controlling for other factors that may influence development. Because an increase in the inclusionary requirement acts like a price reduction for developers (in effect lowering the revenue that developers receive for each BMR unit), reductions in prices (or rents) and increases in the inclusionary requirement will have a similar financial impact on a development project. Therefore, the analysis leads to an estimate, based on the City’s actual experience with changes in prices and the other factors that affect development, the likely impact of a change in the inclusionary policy on the extent of development that is likely to occur.</p> <p>If increasing the inclusionary requirement has only a small impact on the likely extent of residential development, this suggests that land owners or developers are bearing most of the cost of a higher inclusionary requirement. If, however, changes in the inclusionary requirement have a large impact on the extent of development, this suggests that the policy has a greater impact on housing prices, and consumers are bearing more of the costs.</p>
<p><i>Methodology</i></p>	<p>In order to conduct this analysis, the consulting team collected data on each of the more than 150,000 parcels in the City, comparing those parcels that developed as multifamily housing during the period 2001 – 2015 to those parcels that were not developed as housing. For each parcel, the consulting team collected information about the existing land use, zoning, the potential for future development, parking requirements, and other factors. Information was also collected about the neighborhood in which the parcel was located, and the economic conditions that prevailed during each year of the study period, examining things such as construction costs and housing prices, unemployment rates, consumer confidence, stock market returns, interest rates, and other factors that could be associated with the extent of development. The consulting team also estimated the cost of the inclusionary requirements in place for each parcel during each year of the study period.</p> <p>This data was combined into a large data set and used a technique known as regression analysis to examine how the extent of development changed in</p>

	<p>response to changes in the factors believed to be associated with development. Using this approach, the team was able to construct a model which allows us to estimate the likely change in development that would result from different levels of the inclusionary requirement.</p> <p>Our analysis involved developing and testing multiple regression models and several measures of the cost of the City’s inclusionary requirements. Ultimately, the model which best fit the available data and best explains the changes in development in the City relied on several key explanatory variables, including housing prices, construction costs, zoning, the lack of existing residential uses on the site, and development potential (measured as the number of square feet that could be built on a parcel and the ratio of the potential square feet to the current size of the structures on a given parcel). Full details are provided in the appendix.</p>
<p><i>Visual Results</i></p>	<p>The results of our analysis predict where development is likely to occur in the future. By using the characteristics of each parcel, we are able to estimate the likelihood that a particular parcel will develop as housing and compare that likelihood to other parcels in the City.</p> <p>The map below indicates the likelihood residential development in San Francisco, as generated by the model results. Light (grey) areas are unlikely to develop new housing while darker (blue) areas—South of Market, Mission Bay, Central Waterfront, and Visitacion Valley—are more likely to develop, based on past trends.</p>



Implications of Inclusionary Housing Changes

The results of our analysis confirm that residential housing development in San Francisco is sensitive to changes in the City’s inclusionary requirements. Specifically, our results suggest that for each one percentage point change in the City’s inclusionary requirement (e.g. from 17% to 18%), an additional 175 BMR units would be constructed over the next 15 years. In addition, the number of overall housing units in the city is projected to decline by approximately 1.8%. The model does not distinguish between the production of owner-occupied condominiums and rental apartments.

The decrease in total housing units will result in an increase in average housing prices. Previous research conducted by the Controller's Office on the potential impact of Proposition C found that, for example, reducing the construction of new housing in San Francisco by about 18% would increase housing prices and rents (for all vacant market-rate units – not just new units) by about 2%¹.

The table below summarizes the impacts of different onsite inclusionary policies, ranging from 12% inclusionary (the level immediately prior to the

¹ *Increasing Inclusionary Housing Requirements: Economic Impact Report*, February 23, 2016. Available at <http://openbook.sfgov.org/webreports/details3.aspx?id=2278>

passage of Proposition C in June 2016) to 25% (the initial level specified in Proposition C). The table indicates the overall housing production, split between market-rate and below-market-rate (BMR) units, and the average price impact associated with the reduction in overall housing. The "Post Prop C" policies reflect the income limits established by Proposition C, and are assumed to escalate at 0.5% percentage points per year over 15 years (see Recommendation #3 on Page 27).

IMPACT OF INCREASED INCLUSIONARY REQUIREMENTS

Policy	Estimated housing production 2017-2031	Market-Rate Units	BMR Units	Overall housing prices relative to pre-Prop C
Pre Proposition C	31,460	27,685	3,775	0.00%
Post Prop C, 17% Inclusionary	27,215	22,589	4,627	1.48%
Post Prop C, 18% Inclusionary	26,732	21,920	4,812	1.64%
Post Prop C, 19% Inclusionary	26,258	21,269	4,989	1.81%
Post Prop C, 20% Inclusionary	25,794	20,635	5,159	1.97%
Post Prop C, 25% Inclusionary	23,611	17,708	5,903	2.73%

To put these numbers into context, the difference between a market-rate and BMR unit is approximately \$775,000. If the City established an inclusionary policy that averaged 17% (between apartments and condominiums), and increased that rate at 0.5% per year, the city would have 852 more BMR units in 15 years than it would with the pre-Prop C requirements. The direct value of that subsidy would be \$775,000 times 852 or \$660 million, at today's prices.

On the cost side, that policy choice would raise housing prices by 1.48%, as shown in the table. Based on 2014 housing price data², over a 15 year period, the total cost to moving households would be approximately \$1.8 billion a year.

It is important to stress that the direct subsidy is almost certainly not the only benefit of inclusionary or BMR housing. Previous analyses from the Controller's Office have suggested that expanding the housing supply at the low-end of the private market has an indirect price benefit that is primarily captured by low-income households³. As a low-income household moves into a new BMR unit, it creates a vacant unit that will, in most cases, be occupied by another low-income household. If the entire benefit captured by low-income households, the earlier Controller's analysis suggests that low-income

² Based on 2014 American Community Survey data, in 2014, 47,380 or 13% of San Francisco households moved into a vacant housing unit. Their average annual housing expense was \$28,285 (considering owners and renters together). A 1.48% price increase to those households would total \$20 million a year, and households would pay that additional expense as long they remain in the unit. Assuming the same 13% annual churn rate for 15 years, the total cost to moving households would be approximately \$1.8 billion.

³ See *General Obligation Bond for Affordable Housing: Economic Impact Report*, July 8, 2015. Available at <http://openbook.sfgov.org/webreports/details3.aspx?id=2168>

housing affordability would improve, *even for low-income households that did not receive a BMR unit*. However, it is extremely challenging to estimate exactly how much of the benefit of expanded low-income housing supply flows to low-income households.

This simulation model provides some insight into a key question on the economics of inclusionary housing that was posed earlier: is the cost of higher fees and exactions born entirely by the land-owner, or are they shared with developers and consumers?

The fact that the likelihood of development is positive correlated with housing prices, with a 2-year lag, suggests that land prices do not automatically adjust to changes in housing prices. When a policy change, like a fee increase, feels like a price decrease to developers, the likelihood of development declines, indicating at least some projects will be infeasible.

While the statistical significance of the price variable is important, as with any regression, factors outside the model affect the likelihood that a parcel will develop as new housing. The regression analysis sought to capture as many of these factors as possible; however, many of the factors that influence the likelihood that a given parcel will develop are not captured by the model.

For example, many land owners may believe that future economic conditions or changes in City policy will be more favorable to their interests. Therefore, these landowners may hold their land off the market, waiting for a future period in which they hope to obtain a higher price for their land. While price provides an important signal to land owners, these other factors also play a role in a decision to put a particular parcel on the market.

Such speculation about future market and political conditions is beyond the ability of the model to measure. These factors (and others) may well be more significant than changes in the City's inclusionary policy in determining whether a particular parcel will develop as multifamily housing. Therefore, some caution should be exercised in interpreting the results of this analysis.

Nevertheless, the results of our analysis suggest that increasing the inclusionary requirement would reduce the supply of market rate housing in San Francisco, increase the number of below market rate units available for the City's low income residents and the direct subsidy they receive, while raising housing prices for consumers on average.

Best Practices Research

<p><i>Background</i></p>	<p>In order to inform these recommendations, the consulting team researched best practices in inclusionary housing programs in comparable jurisdictions. We interviewed nearly all of the TAC members and facilitated a discussion at the second TAC meeting in order to identify the most significant questions about the design of San Francisco’s current inclusionary housing program. Based on this feedback we identified the focused set of key questions outlined below.</p> <p>Key Questions:</p> <ol style="list-style-type: none"> 1. Variation across project types/locations: How do cities adjust programs in response to the real differences in the economic strength of different neighborhoods or product types? 2. Variation across market cycles: Do any cities adjust inclusionary requirements for different phases of the real estate market cycle? 3. Income Targeting: How do cities determine which income groups to target in their inclusionary programs? <p>Additional policy considerations, which did not lead to policy recommendations, are reviewed in the appendix. In addition, the appendix contains profiles of 5 jurisdictions similar to San Francisco, including:</p> <ul style="list-style-type: none"> • San Jose • San Diego • Seattle • Boston • New York City <p>Rather than outlining a comprehensive set of all best practices for inclusionary housing programs, this section summarizes the range of practices for a highly targeted set of issues. For each of the key research questions, we attempted to briefly outline common approaches among the comparison cities and to highlight options that could be most relevant to San Francisco. In many cases we were also able to find relevant novel approaches in other communities. We collected this information primarily through the review of published reports, ordinances and program administrative manuals available online and through telephone conversations with program administrators. It is important to keep in mind that these programs are all evolving on an ongoing basis and while the information contained in this report is generally current as of the summer of 2016, some of the details will likely change over time.</p>
<p><i>Variation across project types/ locations</i></p>	<p>How do cities adjust programs in response to the real differences in the economic strength of different neighborhoods or product types?</p> <p>The majority of inclusionary housing programs adopt a single requirement which is applied to all project types in all locations (often excluding the</p>

smallest projects). This means that in most cities, the inclusionary requirements are high for some sensitive projects and below the highest level which could be supported by particularly profitable projects in the highest demand locations. We identified 7 distinct strategies that communities have adopted to respond to this challenge:

1. Project by project underwriting:

Some cities including Vancouver, BC set different inclusionary housing requirements for each project based on an evaluation of projected revenues and costs for the specific proposed project. This approach requires very significant internal staffing capacity to underwrite each project, though the workload could be reduced by reviewing only projects above a certain size.

2. Vary requirements by proforma rents/prices:

A few cities have set inclusionary requirements that vary depending on the level of rent or price in a proposed project. For example Burlington, VT requires 15% BMR units in projects where the market rate units are relatively affordable and up to 25% for projects where the market rate units are more expensive.

Average Market Rate Unit Affordable to:	Required BMR units
Up to 139% of AMI	15%
140% to 179% of AMI	20%
Over 180% of AMI (or any project in waterfront district)	25%

Boston takes a similar approach for ownership projects that select the fee in-lieu option. For rental units there is a single fee level for all projects but for ownership projects Boston sets the fee in-lieu based on the projected sales price of the units. The fee is set at one-half of the gap between the average market price and the affordable price. However, they use the in lieu fees from rental projects as a floor so a project pays the higher of what they would have paid for a rental unit and the formula driven ownership fee. This approach allows the city to collect significantly higher fees from the highest cost condo projects.

3. Hardship waivers/appeals:

Many cities set higher requirements but allow any developer to request a partial waiver or reduction in the inclusionary requirements when they can prove that full compliance would make a project economically infeasible. For example, Evanston, IL requires 10% affordable units but offers developers a waiver or reduction if they can:

"provide clear and compelling financial evidence to the City Council that full compliance... would render the development financially infeasible."

The challenge in implementing this kind of open-ended waiver is that it creates an opportunity for favorable treatment of developers with stronger political connections. It is difficult to maintain transparency in a system that allows for case-by-case judgment calls.

4. "True up"/Claw Back:

Among cities that vary requirements on a project by project basis (or allow project specific waivers) some allow for a later audit and 'true up.' Boston, for example, charges ownership projects an in lieu fee that depends on the projected sales prices in the project, with an audit performed 1 or 2 years after occupancy to ensure that the fee paid reflects the actual prices which may change significantly after the time a project is proposed.

5. Vary requirements by 'zone':

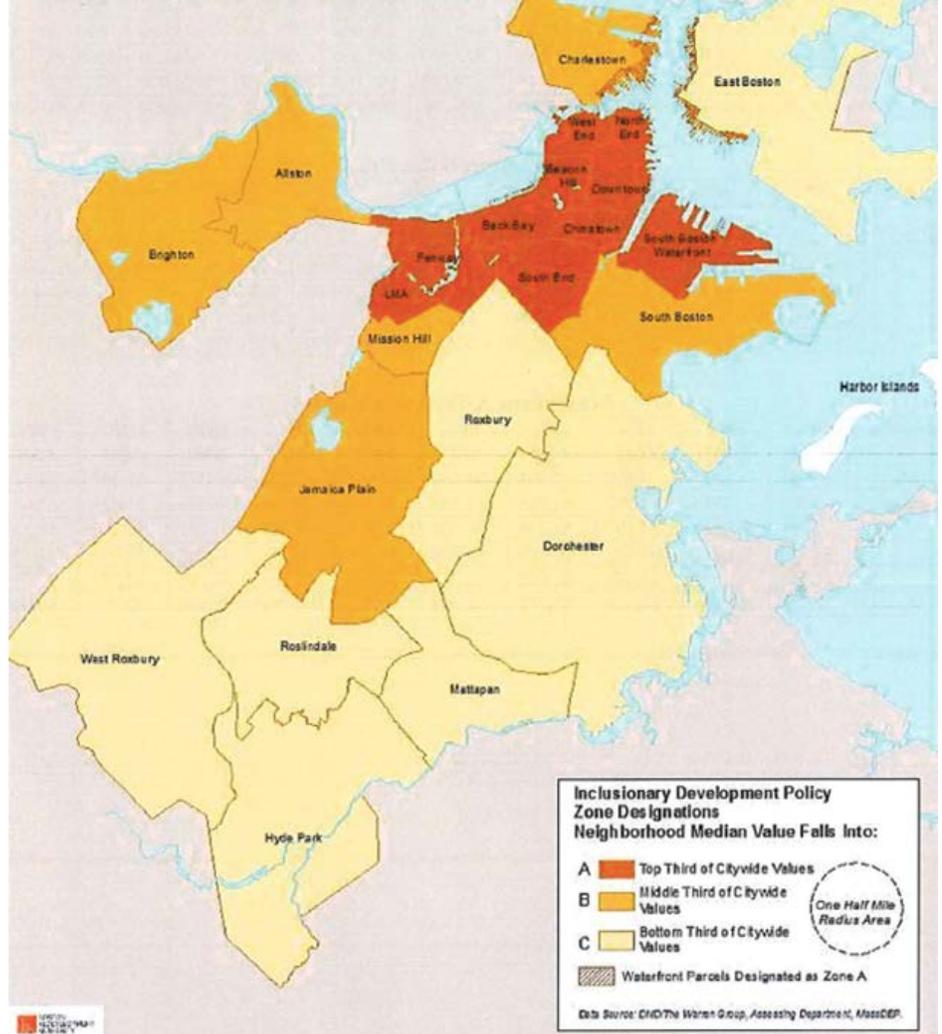
A number of cities have adopted maps which set different inclusionary housing requirements for different zones of the city in order to reduce the potential burden on locations with softer market conditions.



Boston requires 13% of units be affordable onsite but they vary the in lieu fees across three different zones. The zones were identified based on the cost per square foot for condo units. The highest cost locations in the city pay higher fees and the lowest cost areas pay relatively lower fees.

Inclusionary Development Policy Zone Designations

Based on Median Value per Square Foot of Living Area for Condos, One-, Two-, and Three-Family Homes, FY13-FY15



6. Vary requirements by building type/height:

Another common approach is to set different requirements for different building types or building heights. Fairfax County, VA has different requirements for single-family subdivisions, multi-family buildings without elevators and elevator buildings. Most communities taking this approach set lower requirements for highrise buildings due to their higher cost of construction.

7. Vary requirements by project size:

Some cities set requirements that are different for larger projects and smaller projects on the assumption that it may be easier for larger projects (regardless of building type) to absorb affordable housing units or fees. For example, Toronto requires affordable units only in projects on sites larger than 5 Hectares (approx. 12 acres).

Variation across market cycles

Do any cities adjust inclusionary requirements for different phases of the real estate market cycle?

The cyclical nature of real estate markets makes it challenging to implement appropriate inclusionary housing requirements. Requirement levels that are optimal at one point in the economic cycle may seem too high or too low at a different point. We examined three alternative responses to this challenge?

1. Constant Requirements:

Overwhelmingly the response of inclusionary housing programs to this variation in market conditions has been to set requirements that are safely below the maximum feasible at the peak of the market cycle and hold them constant even in the face of market slow downs where they will presumably be too high for many projects.

Maintaining a constant requirement means that programs produce slightly less affordable housing than the absolute maximum at the peak of the market and it may also mean that inclusionary requirements contribute to a somewhat slower recovery of the housing market after a crash. However, most cities appear to have concluded that they are unlikely to successfully time the market. The benefits of predictability and simplicity have tended to win out.

2. Indexing:

The team searched for examples of communities that set their inclusionary housing requirements based on an index of some kind that would allow the economic impact of the requirements move up and down with the market cycle. Other than the few examples cited above where cities adjusted the fees based on planned rents or prices of market rate units, no examples of this approach were found.

It might be possible to construct an index that attempted to adjust the level of inclusionary requirements across the market cycle. One approach would attempt to tie the requirement to changes in land prices. When land prices are rising, it would be logical to increase the inclusionary requirement in an effort to capture some of the benefit of rising prices. When land prices are falling, it would make sense to lower requirements to encourage more land transactions. In practice however the data that is available on land prices is not consistent enough to allow construction of a reliable index for this purpose. An alternative would be to assume that land prices are generally rising whenever rents are rising faster than the cost of constructions (two metrics that are more readily available) and falling when the opposite is true. A third alternative would be to simply track the rate of building permit applications and increase the requirements when permit activity is increasing and decrease it when it declines. Whatever the index, one significant challenge would be providing predictability. Large swings in the inclusionary requirements could make it much harder to developers to pass the costs along to land owners, which could slow the pace of development.

It may be that the complexity of constructing a reliable enough index and transparently publishing it has deterred other communities. It is also not clear that lowering the requirements in an economic downturn will actually have a stimulating effect on real estate development – even if the requirement were to drop to zero most projects will simply not be feasible at the bottom of the market.

3. Phase In:

While not necessarily motivated by the market cycle, many communities adopting inclusionary housing for the first time, phase the requirements in over time in order to allow land markets time to adjust. The idea behind this approach is that land owners will ultimately absorb the cost of increased requirements in the form of lower land prices but that it is unrealistic to expect property sellers to adjust their expectations too quickly. A change that might be infeasible in the very short term, may be more readily accommodated if it is phased in gradually over a number of years.

For example, San Luis Obispo County adopted a 20% inclusionary housing requirement in 2010 but the requirement was phased in over 5 years.

Phasing of Inclusionary Housing Requirement

Year	Year 1	Year 2	Year 3	Year 4	Year 5
Inclusionary Requirement	4%	8%	12%	16%	20%

Conclusions and Recommendations

<p><i>Recommendation 1: The City should impose different inclusionary housing requirements on rental and for-sale (condominium) properties.</i></p>	<p>The majority of inclusionary housing programs across the country adopt a single requirement which is applied to all project types in all locations (often excluding the smallest projects). This means that in most cities, the inclusionary requirements are 'too high' for some sensitive projects and below the highest level which could be supported by particularly profitable projects in the highest demand locations.</p> <p>A smaller number of communities adopt structures that vary the requirements either across neighborhoods, or across project types, in an effort to reduce the burden on projects likely to be most adversely impacted while simultaneously capturing more public benefit where that is feasible. Based on the consultants' best practice research, we considered several alternative approaches that San Francisco that might pursue.</p>
	<p>San Francisco's inclusionary housing program already imposes different requirements on projects of different sizes and in different locations. Many of the areas where the greatest growth is expected have been recently upzoned through area plans which impose inclusionary housing requirements that exceed the citywide requirements. In addition, projects below 10 units are exempt entirely from inclusionary housing and Proposition C set lower requirements for projects under 25 units. The result is an already complex system which can be difficult to administer and explain.</p> <p>While there might be some benefit to varying the requirements between different neighborhoods, given the existing complexity, it seems likely that the costs of such an approach would outweigh any benefit.</p> <p>Several TAC members inquired about the feasibility of setting higher inclusionary requirements for highrise projects. The consulting team explored this idea and did not find evidence to support higher requirements for highrise projects.</p> <ul style="list-style-type: none"> • The best practice research examined other cities that have different requirements for highrise and found only examples where those requirements are lower (due to higher costs for this building type). • The prototype analysis found comparable residual land values for highrise and lower rise prototypes for all levels of inclusionary requirements analyzed which suggests that it would be no easier (or harder) for highrise projects to absorb increased requirements. • The regression analysis found that larger projects were somewhat more sensitive to changes in the fee level which suggests that development of these projects is somewhat less likely in the face of increased requirements.

	<p>The consultants’ research has shown, and the TAC has generally supported, that for-sale projects can feasibly support higher fees than rental projects.</p> <p>The proforma analysis discussed below suggests that at any given level of the inclusionary policy, the typical ownership project could support a higher residual land value. Put another way, the typical ownership project can support roughly 2 percentage points more affordable housing units onsite while maintaining the same residual land value. For example, for rental projects an 18% onsite requirement results in a weighted average residual land value of approximately \$100,000. For ownership projects, an onsite requirement of 20% achieves approximately the same residual land value.</p> <p>At the TAC meeting on September 7, 2016, the TAC endorsed this recommendation unanimously.</p>
<p><i>Recommendation 2: The City should set the initial onsite requirements from 14%-18% for rental projects and 17%-20% for ownership projects.</i></p>	<p>Since 2010, there has been a significant increase in the average price paid by developers for land in San Francisco, equaling 11.5% per year for entitled land.</p> <p>This rapid increase suggests that some landowners would have sold their land to developers for somewhat less than what they received, though not at levels below what was required during the 2010-12 period, when the housing market was in recession.</p> <p>As discussed earlier, the consulting team developed financial models of four different project prototypes, and tested the impact of different inclusionary housing requirements on the land value each type could support. The results, summarized below, indicate that onsite requirements that are shaded red would result in land bids that are below what land prices were in 2010-12 – and thus are infeasible.</p> <p>If the goal is to set fees that minimize harm to project feasibility, analysis of these prototypes imply that initial onsite requirements in the red zone should be avoided. Fees in the yellow zone, which range from 14-18% onsite for apartment projects and 17-20% for condominium projects, are the maximum feasible requirements today.</p>

Residual Land Value Per Unit

(Weighted average of prototypes for each tenure)

Rental	Apartments	Condominiums
Pre Prop C	\$118,600	\$140,400
12%	\$126,300	\$141,600
14%	\$118,900	\$129,900
16%	\$109,300	\$120,800
18%	\$102,000	\$110,700
20%	\$96,100	\$104,300
25%	\$71,800	\$77,800

Assuming no density bonus

More Likely	Residual Land Value > \$120k/unit
Uncertain	Residual Land Value \$100 to 120k/unit
Less Likely	Residual Land Value below \$100K/unit

5

At the TAC meeting on September 7, 2016, the TAC endorsed this recommended range unanimously. TAC member differed on what they felt the specific initial requirements should be, within this range.

*Recommendation 3:
The City should commit to a 15-year schedule of increases to the inclusionary housing rate of 0.5% per year.*

Providing predictability does not mean that requirements can never change, only that any changes should be clear well before they take effect. It is not uncommon for developers to negotiate the price of land several years before receiving building permits.

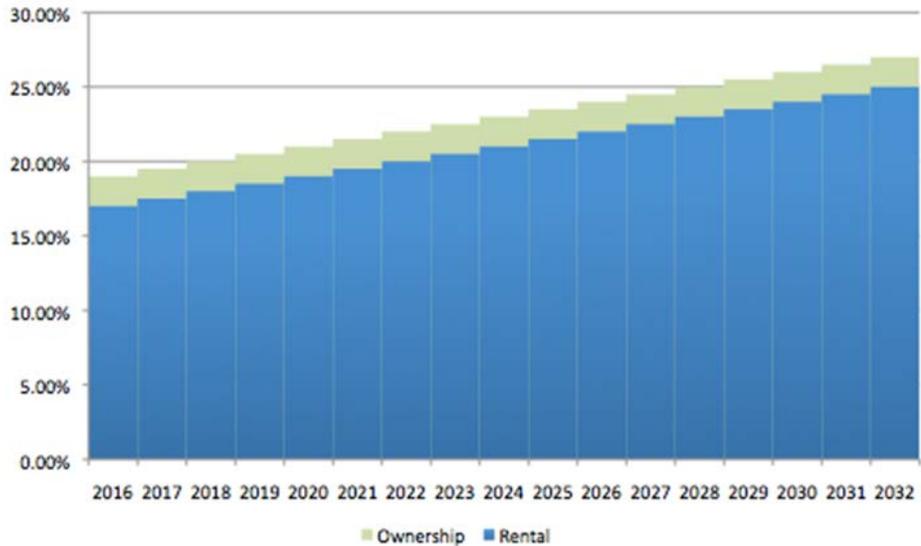
There was agreement among TAC members that increased inclusionary requirements should be phased in over a period of time long enough to allow the land market to adjust. Setting a clear schedule which ramps up requirements over an extended period of time provides the greatest amount of predictability for the housing market.

It is theoretically possible that even a large increase in inclusionary requirements could translate immediately into lower land prices. However in practice, property owners appear more likely to withhold land or seek other alternatives to residential development when faced with significant declines in offering bids from residential developers. Any large step up in requirements might result in immediate reductions in residential development. Gradual increases on a planned schedule are more likely to result in a slowing of the rate of land price increases.

Preliminary analysis suggests that, if 15-year trends in housing prices and construction costs continue for the next 15 years, on average, then a 0.5%

annual increase would yield a roughly even split between future increases in land value, and future additional resources for affordable housing.

Adjusting the requirements at 0.5% per year will ultimately increase the requirements to the range of 21.5%-25.5% for apartment projects and 24.5%-27.5% for condominium projects, as shown in the diagram below. Such an approach, would both capture an equitable share of likely future increases in land value for affordable housing, and promote a well-functioning land market by providing maximum certainty for developers and landowners.



Additionally, every five years the City should conduct a new study of the basic economic feasibility of the inclusionary requirements, as opposed the current three-year legislative requirement. The long term goal should be to move to an environment where policy-makers are frequently asked to consider large changes to the requirements, to one which any changes are made gradually enough for markets to adjust.

At the TAC meeting on September 7, 2016, the TAC unanimously endorsed the recommendations of a 15-year phase-in of higher requirements, with a study every five years.

With respect to the rate of increase, six TAC members supported the 0.5% annual increase recommendation, and two members felt the annual increase should be higher, in the range of 0.75% - 1.0% per year.

<p><i>Recommendation 4: The City should conduct a new analysis to update the schedule of fees.</i></p>	<p>The developer's opportunity cost of providing onsite units increases with changes in the market rents or sales prices. The City's fee option, however, is tied only to changes in construction cost. When the market rises faster than construction costs, as it has over the past decade, the fee option becomes relatively more attractive to developers. Land values in San Francisco have risen by more than 40% since the 2012 study that the current fee schedule is based on.</p> <p>The analysis indicates that for 6 of the 8 prototypes studied the fee option is financially advantageous. However for the 4 rental prototypes, the relative impact on residual land value for projects selecting the fee option and those selecting the onsite option is quite similar, indicating only a small incentive for developers to prefer the fee option.</p> <p>However, for condominium projects, there is a very strong incentive to prefer the fee option. For the highest density projects the residual land value was 30% higher under the fee option. Updating the affordability gap research could result in fees that more closely match the economic impact of onsite units.</p> <p>At the TAC meeting on September 7, 2016, the TAC endorsed this recommendation unanimously.</p>
<p><i>Recommendation 5: The City should impose additional affordability requirements for any 80/20 project financed through the City's financing approval process.</i></p>	<p>It is likely that increasing the inclusionary housing requirements will encourage more project sponsors to consider developing so called '80/20' projects which utilize tax exempt bond financing to subsidize the cost of providing affordable units. All things being equal, leveraging existing public resources should be encouraged, however it should result in greater levels of affordable housing rather than simply reducing the cost of providing otherwise mandated affordability.</p> <p>There was not agreement within the TAC that it would be safe to assume that all future projects would take advantage of this program. As a result the analysis does not assume bond financing is used. However, because the City's approval is necessary before any project accesses tax exempt bond financing, it should be possible for the city to require additional affordable units (or deeper levels of affordability) from all projects accessing this financing in the future.</p> <p>At the TAC meeting on September 7, 2016, the TAC endorsed this recommendation unanimously.</p>

Areas for Additional Consideration & Study

State Density Bonus

The prototype analysis discussed earlier does not specifically address the impact of potential density bonuses on project feasibility. If either the state density bonus or a local bonus program (or both) were widely implemented in San Francisco, the likely result would be higher residual land values in many locations which would support a higher inclusionary requirement. However, it is not currently clear how widely either of these density bonuses would be applied or what share of eligible projects would choose to build the allowed additional units. Without a clearer picture of likely use, it is not possible to know how much the availability of a density bonus would increase the feasible inclusionary housing requirements.

The Planning Department has been developing projections which may make it practical to evaluate the impact of both the state and a proposed local density bonus program on the feasibility of inclusionary housing requirements in the very near future. Since the density bonus is likely to make a significant difference in the financial feasibility of future projects, we recommend completing this additional research before undertaking any legislative change to the inclusionary housing requirements.

At the TAC meeting on September 7, 2016, the TAC unanimously agreed this issue required further study.

Income Limits

The recommended initial range of onsite requirements discussed earlier, and the stepped increase over 15 years, assume that the income split of BMR units will continue match the requirements in Prop C, in which 60% of the on-site units were dedicated to households at 55% of area median income (AMI) or below, and the remaining 40% were for households at 80% of AMI or below. The split between the two groups, as the rate increases, is shown below:

	17.0%	17.5%	18.0%	18.5%	19.0%	19.5%	20.0%	20.5%	21.0%	21.5%	22.0%	22.5%	23.0%	23.5%	24.0%	24.5%	25.0%
55% of AMI	10.2%	10.5%	10.8%	11.1%	11.4%	11.7%	12.0%	12.3%	12.6%	12.9%	13.2%	13.5%	13.8%	14.1%	14.4%	14.7%	15.0%
80% of AMI	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%

These income limits are **not** a recommendation of the Controller's Office or its consulting team; they were used in the analysis because they were adopted in Prop C. It is important to point out that the application of those income limits to the recommended fee ranges would lead to fewer onsite units for households below 55% of AMI than was the case before Prop C. This may not be a desired outcome, and while the recommended initial fee ranges would not necessarily be feasible under different limits, additional study could reveal which fee ranges would be feasible.

	<p>At the TAC meeting on September 7, 2016, the TAC unanimously agreed this issue required further study.</p>
<p><i>Neighborhood-Specific Requirements</i></p>	<p>Due to the time frame for this analysis, the proforma analysis did not evaluate potential differences in financial feasibility between similar prototypes located in different neighborhoods in the city. While several of the prototypes are only likely to occur within fairly limited geographic areas there are some that could occur in quite different locations. It might make sense to conduct further research into these neighborhood differences to better evaluate the value of further modifying the inclusionary requirements for different neighborhoods.</p> <p>At the TAC meeting on September 7, 2016, there was a general consensus among the TAC not to do pursue further research on this issue.</p>
<p><i>When in the Development Process Should Inclusionary Requirements be Set?</i></p>	<p>Committing to a 15 year schedule of annual small increases in the inclusionary requirement creates a need to very clearly define the point in time at which projects inclusionary requirements are fixed. TAC members all agreed that developers should be able to ‘lock in’ a particular requirement level at some point in the development process so that small delays don’t result in later increases in the inclusionary housing requirements.</p> <p>There are advantages to setting the requirement at the point that a developer submits a complete Environmental Evaluation Application. However, because unexpected project delays are not uncommon between this point and the point that a project is entitled, it is difficult to set a simple time period after which the commitment to a specific level of requirements would expire. Once a project is entitled it would be easier to set a simple time limit and impose increased requirements on projects that move too slowly. The TAC requested additional research into options that would provide predictability to developers without allowing projects that are not making good faith progress to hold on to lower requirements indefinitely.</p>
<p><i>Next Steps</i></p>	<p>The Controller's Office, other City staff, and the consulting team plan to research these questions. Based on those outcomes, we plan to issue an addendum to this report that has additional recommendations on these items.</p>

Appendices

Underwriting Assumptions The financial assumptions used by the consulting team in the scenario analysis are detailed in the table below.

Apartments	Underwriting Assumptions			
	Prototype	A	B	C
Construction Type	Type V	Type III	Type Ia	Type Ib
Building Type	Lowrise	Midrise	Highrise	Highrise
1.) Building Stories	5 Stories	7 Stories	13 Stories	24 Stories
2.) Building Height	55 Feet	75 Feet	135 Feet	245 Feet
3.) Gross Square Feet	54,250	133,813	268,000	405,827
4.) Efficiency Factor	80.0%	80.0%	80.0%	78.0%
5.) Parking Ratio	0.25:1	0.25:1	0.25:1	0.25:1
6.) Parking Stalls	13	31	63	94
7.) Apartment Unit Count	50	125	250	375
8.) Weighted Average Unit Size	750 NRSF	750 NRSF	750 NRSF	750 NRSF
9.) Wtd. Average Market Rent	\$3,853 / \$5.12	\$4,085 / \$5.44	\$4,291 / \$5.71	\$4,460 / \$5.95
10.) Hard Costs (Total / Unit) (a)	\$18.6M / \$372,500	\$50.1M / \$400,800	\$115.8M / \$463,000	\$170.9M / \$455,700
11.) Soft Costs (Total / Unit) (a)	\$5.4M / \$107,500	\$13.9M / \$111,300	\$30.9M / \$123,800	\$48.2M / \$128,600
12.) Total Hard & Soft Costs (Total / Unit) (a)	\$24.0M / \$480,000	\$64.0M / \$512,100	\$146.7M / \$586,800	\$219.1M / \$584,300
13.) Total Hard & Soft Costs (/ GSF) (a)	\$442	\$478	\$547	\$540
14.) 55% AMI Wtd. Avg. Rent	\$1,129	\$1,139	\$1,139	\$1,145
15.) 55% AMI Wtd. Avg. Rent PSF	\$1.54	\$1.54	\$1.54	\$1.52
16.) 100% AMI Wtd. Avg. Rent	\$2,100	\$2,151	\$2,125	\$2,116
17.) 100% AMI Wtd. Avg. Rent PSF	\$2.94	\$2.76	\$2.83	\$2.86
18.) Net Operating Income (a)	\$1,524,498	\$4,036,061	\$8,550,307	\$13,251,522
19.) Target Going-in Return-on-Cost	5.05%	5.05%	5.05%	5.05%

Notes:
 (a) Reflects 12% of total units at 55% of the Area Median Income (AMI). Excludes land costs.
 * All financial and programmatic estimates are preliminary in nature, and are not intended as a formal feasibility analysis.
 ** For comparison, the average land prices determined by the City of San Francisco's 2006 Inclusionary Housing Financial Analysis ranged from \$100,000 to \$120,000 per unit; average land prices determined by the 2012 Inclusionary Housing Financial Analysis ranged from \$100,000 to \$200,000 per unit.
 *** The financial analyses shown above reflect institutional investment underwriting assumptions. Financial underwriting assumptions for smaller projects (e.g., less than 35 units) may differ.

Condominiums		Underwriting Assumptions			
Prototype		A	B	C	D
Construction Type		Type V	Type III	Type Ia	Type Ib
Building Type		Lowrise	Midrise	Highrise	Highrise
1.)	Building Stories	5 Stories	7 Stories	13 Stories	24 Stories
2.)	Building Height	55 Feet	75 Feet	135 Feet	245 Feet
3.)	Gross Square Feet	57,625	142,813	286,000	432,827
4.)	Efficiency Factor	80.0%	80.0%	80.0%	78.0%
5.)	Parking Ratio	0.50:1	0.50:1	0.50:1	0.50:1
6.)	Parking Stalls	22	55	111	166
7.)	Condominium Unit Count	44	110	221	331
8.)	Weighted Average Unit Size	850 NRSF	850 NRSF	850 NRSF	850 NRSF
9.)	Wtd. Average Market Sales Price	\$974,000 / \$1,142	\$1,090,000 / \$1,279	\$1,221,000 / \$1,439	\$1,250,000 / \$1,471
10.)	Hard Costs (Total / Unit) (a)	\$19.0M / \$432,000	\$54.7M / \$498,000	\$126.3M / \$572,000	\$186.6M / \$564,000
11.)	Soft Costs (Total / Unit) (a)	\$6.5M / \$147,000	\$17.1M / \$155,000	\$39.6M / \$179,000	\$65.2M / \$197,000
12.)	Total Hard & Soft Costs (Total / Unit) (a)	\$25.5M / \$726,000	\$71.8M / \$653,000	\$165.9M / \$751,000	\$251.8M / \$761,000
13.)	Total Hard & Soft Costs (/ GSF) (a)	\$442	\$503	\$581	\$582
14.)	80% AMI Wtd. Avg. Sales Price	\$264,000	\$258,000	\$262,000	\$260,000
15.)	80% AMI Wtd. Avg. Sales Price PSF	\$310	\$318	\$305	\$310
16.)	120% AMI Wtd. Avg. Sales Price	\$439,000	\$430,000	\$436,000	\$433,000
17.)	120% AMI Wtd. Avg. Sales Price PSF	\$517	\$530	\$508	\$517
18.)	Target Profit as % of Revenue	20.00%	20.00%	20.00%	20.00%

Notes:

(a) Reflects 12% of total units at 90% of the Area Median Income (AMI). Excludes land costs.

* All financial and programmatic estimates are preliminary in nature, and are not intended as a formal feasibility analysis.

** For comparison, the average land prices determined by the City of San Francisco's 2006 Inclusionary Housing Financial Analysis ranged from \$100,000 to \$120,000 per unit; average land prices determined by the 2012 Inclusionary Housing Financial Analysis ranged from \$100,000 to \$200,000 per unit.

*** The financial analyses shown above reflect institutional investment underwriting assumptions. Financial underwriting assumptions for smaller projects (e.g., less than 35 units) may differ.

Regression Analysis Methodology

To analyze the potential impact of an increase in the inclusionary housing requirement on multifamily market-rate housing development in San Francisco, we constructed an empirical model using logistic regression analysis.⁴ This analysis uses actual historical data, including information on the characteristics of the City's parcels over time, the market-rate multifamily development that occurred between 2001 and 2015, and various housing market and other economic indicators. Using this model, we can estimate the change in the probability of development associated with changes in the inclusionary housing requirements as well as changes to factors that would affect the potential size of the development (e.g., increasing height allowances or relaxing maximum density limits) or changes in economic conditions such as increases or decreases in housing prices or construction costs.

To construct the model, we collected the historical data needed to identify those factors most useful for understanding when and where residential

⁴ This statistical approach built on work initially performed by the City's Office of Economic Analysis in their February 2016 report entitled *Increasing Inclusionary Housing Requirements: Economic Impact Report* (<http://openbook.sfgov.org/webreports/details3.aspx?id=2278>).

development occurs. These data consisted of parcel-specific data, demographic data for areas within the City, and annual economic and market data. Specifically, the data included in the analysis consisted of the following:

1. **Parcel-Specific Data**—Data for every parcel in San Francisco were collected for each year from 2001 through 2015.⁵ This information includes attributes which did not change over time such as the parcel’s land area and neighborhood, as well as characteristics that may have changed, such as the parcel’s zoning requirements or maximum allowable building height. The basis for our list of parcels was the current “City Lots” database available from the San Francisco Planning Department. We then added annual files for zoning, height and bulk districts, planning districts, special use districts, and land use.⁶ In addition, the Planning Department also provided information on the maximum allowed density, parking requirements, and setback requirements associated with different planning areas and zoning designations over time. Finally, because parcel identifiers may change over time as parcels are combined or divided, the Planning Department also provided a file that recorded parcel number changes over time.
2. **Demographic Data**—Demographic data were also integrated for regions within the City. Specifically, data for education level and per capita income were collected by census tract from the Decennial Census for 2000 and 2010 and supplemented with annual data from the American Community Survey for 2009-2014.⁷ Where annual data were not available, values were interpolated. GIS software was then used to map parcels to census tracts so that every parcel could be assigned the appropriate annual estimates of education level and per capita income.
3. **Annual Economic Data**—Various measures of housing prices and construction costs were also collected and integrated to account for changes that would have a direct impact on the San Francisco housing market over time, as well as changes in general economic conditions that may influence the amount of housing developed. These economic indicators included data specific to the City, such as total employment and the unemployment rate in San Francisco, as well as data for the greater San Francisco area, including the total employment and unemployment rate and the number and value of residential building permits issued for the San Francisco Metropolitan Statistical Area (MSA). Also integrated were numerous measures of general economic activity and consumer sentiment, including various stock market indices such as the Dow Jones Total Stock Market Index (DJ-TSM), S&P 500, and the

⁵ San Francisco assigns a unique BLKLOT identifier to each of the 200,000-plus parcels in the City (the BLKLOT is also the Assessor Parcel Number or APN). However, multiple level (condominium, live/work, et al) lots were also included in the parcel data they provided, with their ground or base lot assigned a unique MAPBLKLOT key. This analysis relies on the MAPBLKLOT value to identify the base lot for each parcel, which represents just over 154,000 unique base lots.

⁶ These annual files were provided by the San Francisco Planning Department. Most are also publicly available via the “SF OpenData” website (<https://data.sfgov.org/>).

⁷ Education level was defined as percent of the population 25 years or older with a Bachelor’s degree or higher.

NASDAQ; data on venture-backed companies in Northern California from the Sand Hill Index of Venture Capital; interest rates; and measures of consumer sentiment as reported by both the Conference Board and the University of Michigan. Finally, data for various price and cost indices specific to San Francisco were integrated, including an annual index of housing prices developed by the Office of Economic Analysis (OEA), a comparable housing price index based on data from Zillow, a Building Cost Index and a Construction Cost Index prepared specifically for San Francisco by the Engineering News Record (ENR), and a commercial rent index that is produced by Real Facts based on the asking rent data from a consistent set of properties within the City.

4. **Historical Market-Rate Housing Development Data**—Finally, data for market-rate multifamily housing developments completed in San Francisco from 2001 to 2015 were integrated. This list was prepared from the Planning Department's annual Housing Inventory reports. The dataset included the parcel number identifier(s) for each project, the year the project was completed, and the number of market-rate and below market-rate (BMR) units for each project.

These data sources were combined to form a single data set, with one record for each of the City's 154,342 current "base lot" parcels for each year from 2001 to 2015. In addition to the data collected, additional potential explanatory variables were also constructed for this analysis. First, the variable "RES_DUMMY" was assigned a 1 if the parcel had any indication of existing residential use for that year, otherwise it was assigned a zero. Second, the "building envelope" was calculated as the maximum potential residential square footage for each parcel in each year using the parcel's land area, maximum allowable height, setback requirements and maximum allowable density in that year. Finally, the amount of additional development capacity was calculated by dividing the building envelope by the greater of the square footage of the existing building(s) on the parcel for that year or the land area of the parcel if there were no buildings or the information was missing.

Data limitations mean that analyzing the San Francisco housing market is challenging. First, there are relatively few multifamily developments completed each year. Over the 15-year period analyzed, there were on average about 20 parcels that experienced this type of development each year out of a total of over 154,000 parcels. Second, many factors can account for why and when specific parcels get developed, and not all of these factors can be modeled using available data. In addition, while much of the historical data are reliable, some measures such as historic land use or the existing building characteristics for a parcel in a specific year, are less reliable, especially for the early part of the time period analyzed. Finally, these projects typically take several years to complete and include many decision points, such as purchasing the land, navigating the entitlement process for the parcel(s), getting approval and securing building permits from the City for the project, and demolishing existing structures if they exist and otherwise

preparing the land, all of which must be completed before the construction phase even begins. At each point in this process, the developer may choose to continue, delay, or even halt the development based on actual changes in current market conditions or the expectation of future changes in costs, housing prices, investor concerns, or other factors. This extended and uncertain time horizon adds and extra level of complexity to the analysis.

With these challenges in mind, we analyzed the data set described above to determine which factors are most useful for estimating the probability that a San Francisco parcel will add market-rate multifamily housing in a given year. To do this, we used a common statistical technique called logistic regression analysis. A logistic regression is a special type of regression used to understand the relationship between a dependent binary or dichotomous variable and one or more independent or explanatory variables. Here, the dependent variable is assigned one of two values: a one if the parcel added market-rate housing in a specific year, otherwise a zero. The explanatory variables included both continuous variables, such as the price of housing or the maximum potential size of such a development on the parcel, and binary (or “dummy”) variables, such as whether or not the parcel already had some residential use.

To determine the best model, it was necessary to conduct numerous tests and investigate a variety of potential specifications. First, to account for the long development horizon, we tested numerous time differences or “lags” between the explanatory variables and the dependent development variable. This included up to three year differences for all of the explanatory variables together and testing different lags for individual explanatory variables such as housing prices, construction costs, interest rates, stock market indices, and consumer sentiment indicators. We also examined the completed projects specifically to determine when changes such as land use descriptions, permit applications, recorded square footage of buildings on the parcel, and other changes occurred relative to the year of completion. These investigations indicated that, in general, a two year lag between the completion of the project and the explanatory variables taken together was the most appropriate lag. Thus, a project that was completed in 2013 was best modeled by using the parcel characteristics and market conditions from 2011.

It was also necessary to test different combinations of explanatory variables to see which mix resulted in the best model for predicting whether or not a parcel was developed. Many of the potential explanatory variables are highly correlated with one another (e.g., the S&P 500 and the NASDAQ stock market indexes) and therefore are unlikely to provide useful additional information individually when included together. To identify those explanatory variables that are most useful for understanding when and where housing is added, we first developed a base model that included those variables most likely to be closely associated with housing development based on economic theory. Those variables include housing prices, construction costs, zoning restrictions, current land use, the size of the potential development given height and

density restrictions, and the relative increase for the potential development given the existing development on the site. With this as our base model, we tested the impact of adding other explanatory variables such as various stock market indexes, interest rates, total employment and the unemployment rate for San Francisco and the Bay Area, building permit activity, etc. These tests were evaluated based on their overall impact to the model as well as their individual predictive power. Many of these added economic variables were highly correlated with housing prices and construction costs while others did not have a statistically significant relationship with development. These variables were therefore excluded from the final model. Throughout these tests, however, it was clear that housing prices and construction costs were consistently useful predictors of development, and the nature of this relationship was quite stable regardless of the inclusion or exclusion of these additional explanatory variables.

In addition to these tests for which control variables to include, we also examined an alternative measure of our key explanatory variable. Specifically, our analysis sought to identify the relationship between changes in the City's inclusionary requirement and the likely extent of development. To measure this effect, our base model included a measure of housing prices. Because an increase in the inclusionary requirement acts like a price reduction for developers (in effect lowering the revenue that developers receive for each BMR unit), changes in prices (or rents) and changes in the inclusionary requirement will have the same financial impact on a development project. In addition to prices, however, we also sought to directly measure the impact on development of changes in the inclusionary requirement which occurred during the study period. Data limitations, however, prevented us from incorporating a measure of the cost of the inclusionary requirement which was deemed sufficiently reliable for our analysis. The final specification, therefore, relies on the housing price measure as the key explanatory variable used to model the likely impacts of changes in the inclusionary requirement.

After completing these tests, the final model consisted of the following explanatory variables:

1. a dummy variable for whether or not the parcel had existing residential use,
2. the OEA house price index (set equal to 100 for 2015),
3. the SF construction cost index,
4. the potential building envelope expressed in thousands of square feet,
5. the ratio of the potential building envelope to the existing square footage, and
6. dummy variables for the type of zoning for the parcel.

The logistic regression results are presented in the table below.

Logistic Regression Results

Logistic Regression Results		
Dependent Variable:	Developed_2yrsBack	
Num Obs	2,004,240	
Max Rescaled R-Square	0.22027	
	<u>Coefficient</u>	<u>Prob>Chi Sq</u>
Intercept	(9.5595)	0.0000
Residential Existing Use (Dummy)	(1.6737)	0.0000
OEA House Price Index	0.0269	0.0026
SF Construction Cost index	(0.0003)	0.0006
Potential Bldg Envelope (1,000 sqft)	0.0001	0.0000
Potential Envelope SqFt / Existing SqFt	0.1669	0.0000
Zoning Categories*		
z_Commercial (Commercial)	3.5209	0.0000
z_DTR (Downtown Residential)	1.5524	0.1631
z_MixedUse (Mixed Use)	4.7055	0.0000
z_PDR (Production, Distribution, Repair)	2.8442	0.0000
z_RC3 (Residential-Commercial, medium density)	4.3777	0.0000
z_RC4 (Residential-Commercial, high density)	4.1278	0.0000
z_Redev (Redevelopment plan areas)	4.8815	0.0000
z_RM1 (Residential-Mixed, low-density)	(2.6563)	0.0002
z_RM2 (Residential-Mixed, moderate-density)	(0.9473)	0.1111
z_RM3 (Residential-Mixed, medium-density)	2.4503	0.0013
z_RM4 (Residential-Mixed, high-density)	3.7470	0.0000
z_RSD (SOMA, residential service)	3.8154	0.0000
z_RTO (Residential Transit-Oriented district(s))	3.4773	0.0000
z_SLU (Service/Arts/Light Industrial)	3.3848	0.0000
z_SLR (SOMA: Service/Light Industrial/Residential)	3.1070	0.0000
z_SSO (SOMA: Service/Secondary/Office)	4.7322	0.0000
* Omitted zoning categories include low-density residential, open space, public and "missing."		

The regression analysis described above considered numerous combinations of potential explanatory variables and a variety of model specifications with different time lags. As shown in Figure 2, each of our key explanatory variables was highly statistically significant (at the 99% level or higher).

The resulting model indicates that there are indeed a number of factors that are associated with a higher or lower likelihood of a San Francisco parcel adding market-rate multifamily housing. First, this analysis shows that both the price of housing and the cost of construction matter. Housing prices have a positive correlation with development; that is, the probability of a parcel adding market-rate housing is higher when housing prices are higher. This relationship has been both stable and statistically significant across various model specifications. Construction costs also have a stable and statistically significant correlation with development, though as one would suspect, this relationship is a negative one, meaning that an increase in construction costs

is associated with a decrease in the probability of a parcel adding market-rate housing, all else equal.

Second, the size of the potential development, which is primarily driven by height restrictions and density limits, also matters. The potential size of the housing that can be developed on the parcel is positively correlated with the addition of multifamily market-rate housing. In addition, the relative difference between potential development and existing structures on the parcel also matters. Those parcels with smaller or no existing buildings are more likely to see housing added than parcels that already have large structures on them. This finding also makes economic sense, as it indicates that those parcels with larger current development are likely to be generating more existing income for the landowner and therefore have a higher current use value than parcels with little or no development.

The regression model described above can be used to estimate the impact of various inclusionary policies. Specifically, because a higher inclusionary requirement results in less revenue for a developer (or increased costs), the financial impact is the same as a reduction in home prices. The regression model estimates how the likelihood of development changes as prices change. Therefore, we can use this empirical relationship to estimate how the likelihood of residential housing development will change when inclusionary requirements are changed.

Based on this relationship derived from our regression analysis, we developed a simulation model to estimate the likely change in development that would result from setting an inclusionary policy at various levels. Figure 1 on page 17 shows the results of our simulation model.

To estimate the baseline and adjusted level of housing production, we utilized the results of our regression model, applying the coefficients for housing prices and construction costs and estimates of the amount that developers could charge for a BMR unit to estimate the cost of the inclusionary policy under each of the scenarios presented. These results are based on the assumption that real growth in housing prices and construction costs over the next ten years will match the levels observed during our study period (2001 – 2015). Results further reflect the assumption that the BMR unit price will not increase in real terms over this period.

This section includes further results of the consulting team's best practices research, and program profiles of other cities.

Unit mix requirements

Do some programs require builders to offer units with more bedrooms?

Nearly all inclusionary programs require that affordable units are equivalent to the product type (rental vs. ownership), bedroom counts, and construction quality of market rate units.

Programs express this requirement in different ways. Some programs require that the inclusionary units do not have a greater proportion of efficiency and one bedroom units (Montgomery County, MD; Washington, DC) while others require that there is an equal or greater proportion of larger two and three bedroom units amongst the affordable stock (New York City). The majority of jurisdictions simply require that the total bedroom count is proportionately equivalent between the affordable and market rate units (Boulder, Burlington, Boston, Cambridge, Sacramento, and others).

Other inclusionary programs offer developers the discretion to provide different product types. For instance, San Jose's program gives developers the option to provide rental units when satisfying the inclusionary on-site requirement for a development of for-sale properties (Section 5.08.500 A). Similarly, Denver's inclusionary program includes a provision for developers to negotiate with the City to provide a different product than the market rate units. These provisions can include either the product type (rental vs. ownership) or fewer units than otherwise required if they are of a higher bedroom count (Section 27-106). Sacramento's program also provides discretion to the Planning Director to require opportunities for "diverse family sizes" by requiring different numbers of bedrooms in inclusionary units (Section 17.190.030 E).

Emeryville's affordable housing program requires that affordable rental and ownership units be proportionate to in mix and type to the project as a whole (Section 9-5.402). In addition, Emeryville's regulations on multi-unit residential development stipulate a strict unit mix requirement (Section 9-5.2003). Specifically, more than half of all units must have two or more bedrooms with at least 15 percent of the project's units containing at least three bedrooms. The ordinance also requires that no more than 10% of the entire project be comprised of studios.

Public land

How do inclusionary housing programs account for development occurring on publicly owned land?

Public land is rarely considered in the calculation for inclusionary zoning incentives, or among other policy considerations. Among the cities that were surveyed, considerations for use of public land were only made in Washington

DC. In 2013, the City Council approved the Disposition of District Land for Affordable Housing Amendment Act. The amendment specified that if a residential development is built on disposed public land then that development would be subject to a significantly higher inclusionary requirement: 30-percent of units must be made affordable in areas with transit access, and 20-percent of units for all other development areas. Transit access areas are defined as those areas within one-half mile of a Metro station, or within one-quarter mile of a major bus route or streetcar line. The inclusionary set-aside requirements for all other development are 10-percent of all units in in low rise zones, and eight-percent of all units in high rise zones.

Home Owner Association fees

How do cities protect affordability in ownership units where HOA fees might rise dramatically?

Many cities struggle with the impact of rising HOA fees on affordability of ownership units. Both special assessments and increases in monthly fees can create real financial hardship for existing owners and make it difficult to find buyers at resale.

This is currently a problem for which there is no perfect solution. Cornerstone Partnership (now Grounded Solutions Network) published a short guide to best practices among inclusionary housing programs in responding to this challenge . Most of the solutions that they describe are either currently being implemented by San Francisco or are prohibited under California Law.

In some other states it is possible for cities to require differential HOA assessment formulas that are based on the value of each unit or reduce the cost or even set a cap for BMR owners. California law does not permit any of these approaches.

Many California cities have responded to this challenge by ensuring that HOA fees are set at realistic levels initially and by pricing BMR units initially at a level below the maximum cut off for eligibility so that there is 'room' for increases in HOA fees before the monthly costs exceed what the highest income eligible buyer could afford. Adding this kind of cushion, as San Francisco currently does, can reduce the risk, but it does not eliminate the chance that at some future point the fees could erode affordability. The problem is especially acute for the highest cost projects. Another approach is to encourage the fee option for condo projects, particularly the highest cost condo projects.

Alternatives to onsite development

Are there cities that offer alternatives that San Francisco does not currently allow?

Most inclusionary housing programs offer project sponsors a menu of several alternative means of satisfaction beyond onsite provision of affordable units.

The most common alternatives are payment of an fee in-lieu of development, off-site development and land dedication. Alternatives other than these are quite rare but there are some. Two examples may be worth considering in San Francisco:

Preservation of existing stock: Several cities allow developers to purchase and renovate existing market rate housing and preserve it as permanently affordable housing as one means of satisfying their inclusionary housing obligations. Since 2000, Boulder, CO has allowed this option though it has not been widely used. As development sites become more scarce, this option may become more popular. Boulder provides detailed livability guidelines and sets cost standards for renovations to ensure that the resulting affordable units are high quality and likely to hold up over time. In addition the program gives the City Manager broad discretion to consider construction type and quality, project configuration, project age and project location before approving the use of this alternative.

Transferrable Credits: Several cities have explored the potential to create resellable credits for offsite production. San Jose (SJM Section 5.08.540.C) has authorized what they call 'Surplus Inclusionary Housing In-Lieu Credits.' This program enables developers of market rate projects to purchase credits from developers of other projects that built more than the required number of affordable units. The 'surplus' units must have been built without city subsidy and the City Manager must determine that the following conditions have been met:

"A. A developer who constructs a surplus inclusionary unit may utilize such surplus inclusionary unit to satisfy the inclusionary housing requirement for future residential development for a period of no more than five (5) years after issuance of the certificate of occupancy for the surplus inclusionary unit.

B. A developer who constructs a surplus inclusionary unit may sell or otherwise transfer the surplus inclusionary credit to another developer in order to satisfy, or partially satisfy, the transferee developer's inclusionary housing requirement.

C. The inclusionary housing restrictions shall be recorded against the market rate residential development and the inclusionary unit pursuant to this chapter and the inclusionary housing guidelines. The restrictions on the inclusionary unit shall commence upon the initial sale or rental of the inclusionary unit at the affordable housing cost occurring subsequently to the approval of the affordable housing plan in which the inclusionary unit is offered to satisfy the requirements of this chapter.

D. The transferee developer who utilizes any surplus inclusionary housing credit shall comply with the timing requirements for inclusionary units to be made available for occupancy concurrently with the market rate units in the residential development pursuant to Section 5.08.460."

Other Impact Fees

How do the requirements created by an inclusionary housing program relate to the requirements imposed by other impact fees?

Many inclusionary housing programs, including in-lieu fee programs, consider the economic viability of residential development projects to determine the inclusionary requirements and fee levels. In San Diego, the nexus analysis justified inclusionary requirements of between 11-percent and 27-percent of a development's total units, depending on the type of development project. Despite the nexus analysis' findings, San Diego implemented a 10-percent requirement and corresponding in-lieu fee in order to prevent the fees from stifling development.

A prime example of a jurisdiction evaluating the total fee burden before adopting an in-lieu fee for affordable housing can be found in Emeryville, California. In 2014, Emeryville adopted a sizable affordable housing in lieu fee (\$20,000 per dwelling unit at the time of adoption) and also decided to limit the other development impact fees that it would levy on new development. While Emeryville adopted a housing impact fee, park facilities impact fee and traffic facilities fee, it also chose not to adopt an impact fee to fund general government facilities. This decision was partially based on an analysis of the total development fee burden. Emeryville hired a consultant to compare all development fees to the estimated market value of various hypothetical development projects across several local jurisdictions. The comparison included the aforementioned proposed affordable housing, park, general government and traffic facilities impact fees, permit fees and other development exactions. Total fee burden was expressed as a percentage of market value. Emeryville's elected officials ultimately set the affordable housing fee level at a rate that was less than the maximum justified by the nexus analysis in order to restrict the fee burden across all development fees to a competitive level in the region.

Similar to Emeryville, the City of Oakland also recently adopted a full suite of impact fees and had to consider total fee burden when allocating fees between different facility categories (affordable housing, capital improvements and traffic improvements). Oakland commissioned an economic feasibility analysis to evaluate the feasibility of the proposed impact fees. The nexus analyses for affordable housing, traffic and capital improvements all justified maximum fees that exceed an economically viable level as identified by the economic feasibility study. As a result, the City's impact fee stakeholder working group recommended fees that were less than the maximum justified for all fee categories. The fee amounts allocated to each fee category were only minimally based on quantitative analysis. The traffic mitigation fee was set at a base level such that developments that pay the fee have met cumulative CEQA traffic mitigation requirements. Aside from the CEQA considerations for the traffic fee, the other fee levels were set based on policy and political decisions. The City's provision of affordable housing was, and still is an important topic in Oakland. As such, the majority

	<p>of the fee capacity was allocated to the affordable housing impact fee. A minimal amount was allocated to the capital facilities fee, without any particular quantitative analysis.</p>
<p><i>Profiles of Other Programs</i></p>	<p>San Jose</p> <hr/> <p>Background</p> <p>San Jose’s current inclusionary housing ordinance passed in January of 2012 and replaced an older version from 1988 that applied only in former redevelopment areas. The new requirement of 15-percent affordable units in developments above 20 units did not immediately go into effect due to legal issues. The <i>Palmer vs. L.A.</i> decision suspended the ordinance’s inclusionary requirement for rental housing developers. The California Building Industry Association also challenged the legality of the ordinance although the California Supreme Court dismissed this challenge in June of 2015. The City Council is expected to consider several measures for final implementation of the ordinance in the fall of 2016. In November of 2014, the City added to its requirements by instituting an affordable housing impact fee of \$17 per square foot for rental housing developments city-wide. The impact fee resolution was supported by a nexus study conducted by Keyser Marston and Associates.</p> <p>Inclusionary Housing Ordinance</p> <p>The City’s inclusionary requirement of 15-percent affordable units applies when 20 or more units are created by new construction, conversion of a non-residential use to for-sale dwelling units, or conversion of rental housing into for-sale dwelling units. The ordinance originally intended to go into effect on January 1, 2013 but the City delayed implementation until July 1, 2016 to await the result of pending litigation. Developments are eligible to avoid this requirement under a number of conditions: vested development rights current as of June 30, 2016, finalized planning permits current as of June 30, 2016, projects regulated by development agreements, developments with signed agreements with the former redevelopment agency and developments in certain planned communities.</p> <p>Developers satisfy the inclusionary requirement by providing 15-percent of the total units on-site at prices affordable to households earning less than 110-percent of Area Median Income (AMI). These inclusionary units would then be sold to households earning less than 120-percent AMI who, at least initially, must occupy them. A developer can also choose to provide the inclusionary units as rental housing where nine-percent are affordable to moderate and low income households and 6-percent to very low income households. Units must be of comparable quality as market rate units and developed concurrently with the market rate units. For-sale units must remain affordable for 45 years and rental units must remain affordable for 55 years.</p> <p>Developers have the option by-right to satisfy inclusionary requirement through a combination of a number of alternative mechanisms:</p> <ul style="list-style-type: none"> ● Building off-site affordable housing units equivalent to 20-percent of the total units provided in the development. These units must conform to the same inclusionary housing affordability and quality

requirements as on-site construction. Units must be in the same redevelopment area unless this requirement is waived by staff. (SJMC 5.08.510 - Off-site construction)

- Pay an in-lieu fee per unit equivalent to the difference between the median sale price of a comparable unit in San Jose and the price affordable to a household earning 110-percent of AMI. This price is to be established annually by Council resolution and can be reduced for buildings taller than 10 stories to incentivize high rise construction. (SJMC 5.08.520 - In lieu fee)
- Dedicate land to the City with an assessed value greater than or equivalent to the in-lieu fee conditional on the land being appropriate for housing. (SJMC 5.08.530 - Dedication of land in lieu of construction of inclusionary units)
- Purchase credits or transfer the rights from surplus inclusionary units to apply affordable housing built elsewhere to another development's inclusionary housing requirement. Developers may sell or transfer credits from inclusionary units built in excess of a development's requirement to satisfy the requirement of a different development. Surplus inclusionary housing credits expire five years after a development receives its certificate of occupancy. (SJMC 5.08.540 - Credits and transfers)
- Acquire and rehabilitate two affordable housing units to satisfy the requirement to build one inclusionary housing unit. The rehabilitation work must equal at least 25-percent of the dwelling's value prior to rehabilitation. In addition, these units have to be completed concurrently or prior to the market rate development, must have a bedroom count comparable to the market rate units and cannot be used as inclusionary credits. (SJMC 5.08.550 - Acquisition and rehabilitation of existing units)
- Providing two HUD restricted units satisfies the requirement for one inclusionary housing unit. (SJMC 5.08.560 - HUD restricted units)

Developers may choose any combination of these methods to satisfy the inclusionary requirement. Affordable housing units created through a density bonus program may not be counted towards the inclusionary requirement. Alternative units must conform to the City's affordable housing dispersion law that requires that affordable housing not be overly concentrated geographically. Finally, inclusionary housing units must be built concurrently with the market rates and there are restrictions around the issuance of certificates of occupancy to ensure compliance.

Affordable Housing Impact Fee Resolution

The affordable housing impact requires a payment of \$17 per square foot for all rental housing developments in the City. The enabling resolution includes an annual increase of 2.4-percent each successive July 1 to account for inflation. Developers must pay the impact fee before receiving any building permits. Developments in the Downtown High-Rise Incentive Area are exempted from the fee if they receive their certificate of occupancy on or before June 30, 2021.

There are a number of exceptions to the impact fee requirement: single

family homes, duplexes, affordable housing developments, developments that have received a planning permit prior to July 1, 2016 (planned development permit, conditional use permit, site development permit, or special use permit), or developments regulated by the City's inclusionary housing ordinance. Units exempted by their planning permit must receive certificates of occupancy for at least half of the units in the development by January 21, 2020 to avoid paying the fee.

San Diego

Background

San Diego's Inclusionary Housing Ordinance was enacted in July 2003, and amended in 2011. The ordinance requires all residential developments greater than two units to set aside at least 10-percent of units for low and moderate-income residents, or pay a fee in-lieu of this requirement. The 2011 amendment to the ordinance was supported by the *Residential Nexus Analysis*, prepared by Keyser Marston and Associates. In particular, the 2011 amendment sought to revise the ordinance in order to comply with the court's recent *Palmer* decision, which prohibited the requirement of on-site affordable rental housing as part of an inclusionary housing plan. Ultimately, while the *Residential Nexus Analysis* provided justification for an inclusionary requirement of between 11-percent and 27-percent, depending on the type of development, the City chose to implement a 10-percent requirement.

Inclusionary Housing Ordinance

The inclusionary housing in-lieu fee applies to all new residential development (including condominium conversions) of two or more units. Developments are eligible to avoid this requirement under a number of conditions:

- Projects where at least 10-percent of the units (5-percent for condominium conversions) are affordable to, and occupied by targeted households (Rental at 65-percent AMI; For Sale at 100-percent AMI).
- Condominium conversions with all units selling at 80-percent AMI or less.
- Projects or portions of projects with units selling at 150-percent AMI or less. Units must contain two or more bedrooms, and must be sold to persons who own no other property and will reside in the unit as their primary residence.
- Projects subject to the North City Future Urbanizing Area inclusionary housing requirements.
- Rehabilitation of an existing building that does not result in a net increase of dwelling units. (§ 142.1303)

Alternatively, developers can satisfy the requirements through building affordable units off site within the same planning area. Offsite in-lieu units satisfy the requirement only if the following supplemental findings are made:

- The portion of the proposed development outside of the community planning area will assist in meeting the goal of providing economically balanced communities; and
- The portion of the proposed development outside of the community

planning area will assist in meeting the goal of providing transit-oriented development. (§ 142.1308 c)

Further, a developer can satisfy the requirements of the ordinance by transfer of credits of affordable units built by other developers, if approved by the City's planning director.

Annual Fee Adjustment

The fee is adjusted annually, based on the following formula and shall not exceed the amount determined as follows:

- 50-percent of the difference between the median sales price of all homes sales in the City of San Diego for the last year prior to the time of adjustment and the sales price affordable to a median-income family of four.
- The product of the above calculation shall then be multiplied by 10-percent, in order to represent the level of obligation under the Program.
- The product of the above calculation shall then be divided by the average size in square feet of a unit constructed within the City of San Diego, in order to determine the level of the fee. Average size of a unit may be adjusted from time to time.
- The applicable square foot charge for developments of less than 10 units shall be prorated, as follows: The base rate for proration shall be equal to the rate used for the Affordable Housing Fee calculated above. The base rate shall be prorated based upon the number of units in the development. The applicable square foot charge (i.e., the rate) for a development of two units shall be 20-percent of the base rate. The applicable square foot charge (i.e., the rate) shall increase by 10-percent for each additional unit in the development, up to 9 units, as illustrated in the Existing Prorated Affordable Housing Fee Chart. The applicable square foot charge (i.e., the rate) for a development containing nine units shall be 90-percent of the base rate.

See **Tables 1** and **2** for the current inclusionary affordable housing fee rates for residential and condominium developments, respectively.

**Table 1 - Inclusionary Affordable
Housing Fee Rates
for Residential Projects**

<u>Units in Development</u>	<u>Fee per Square Foot</u>
2	\$ 1.87
3	2.81
4	3.74
5	4.68
6	5.62
7	6.55
8	7.49
9	8.42
10 or more	9.36

**Table 2 - Inclusionary Affordable
Housing Fee Rates
for Condominium Conversion Projects**

<u>Units in Development</u>	<u>Fee per Square Foot</u>
2	\$ 0.93
3	1.40
4	1.87
5	2.34
6	2.81
7	3.27
8	3.74
9	4.21
10 units or more	4.68

North City Future Urbanizing Area

The inclusionary housing requirement is higher for housing developers in the North City Future Urbanizing Area, who must dedicate 20-percent of their units to affordable buyers or renters. This requirement can be fulfilled by: 1) a set aside of no less than 20 percent of the units for occupancy by, and at rates affordable to, families earning no more than 65 percent of median area income, adjusted for family size, or 2) a dedication of developable land of equivalent value. Developers of projects with ten or fewer housing units and projects falling within the estate and very low-density residential category may, at the discretion of the City, satisfy the requirements of the inclusionary program by donating to the City an amount of money equivalent to the cost of achieving the level of affordability required by the inclusionary program. The Future Urbanizing Area includes the Carmel Valley neighborhoods of Black Mountain Ranch, Del Mar Mesa, Pacific Highlands, San Dieguito and

Torrey Highlands.

Seattle

Background

While they are currently debating adoption of a mandatory inclusionary housing program, Seattle has had a voluntary “incentive zoning” program in various forms for several decades. The program aims to incentivize the development of affordable housing and other community amenities by offering density bonuses to developers who include affordable housing and amenities onsite, or pay a fee to fund affordable housing and amenities offsite. The City has used variations of incentive zoning programs since the 1960s. Commercial buildings were added to the program in the 1980s, and most recently, residential buildings were added in 2006.

Program Details

Program specifics vary by zone; however, in each program property owners may gain extra floor area beyond the base development capacity up to a maximum development capacity by providing public benefits according to specified ratios and standards. Developers can either build affordable housing on site (“performance option”) or contribute to an affordable housing fund (“payment option”).

To obtain bonus residential floor area for affordable housing, the applicant has the option to use the performance option, the payment option, or a combination of these options, subject to the provisions of the zone. However, where the maximum allowable height under the applicable provisions of the zone is 85 feet or less, the applicant may only use the performance option (Section 23.58A.014).

For zones with height limits greater than 85 feet, extra floor area must be gained by providing a combination of benefits. For residential floor area, 60-percent of the floor area must be gained by providing affordable housing and 40-percent through other benefits (Section 23.58A.012B).

In the Downtown Mixed Commercial Zone, the following rules apply (similar programs exist in other downtown zones); developers may build to 290'. Between 85' and 290', developers are able to acquire additional square footage, to a maximum established by code, by participating in a bonus program. They can also build higher than 290' (up to a maximum height of 400') by participating in a bonus program. To participate in the program, developers must first commit to building a LEED Silver certified structure.

Currently, under the payment option the in-lieu fee is \$15.15 per gross square foot of bonus floor area for residential. These fees are being increased to \$21.68 and will automatically increase over time.

Eligible Zones

The Residential Bonus Program is available in the following zones:

- Downtown on sites zoned DOC-1 Unlimited/450- Unlimited, DOC-2 500/300-500, DMC 240/290-400, and DMC 340/290-400;
- South Downtown on sites zoned DMC, DMR, IDM, IDR, and in certain PSM zones;
- On lots in any zones with an incentive zoning suffix;
- In urban villages, urban centers and the Station Area Overlay District

- on lots zoned MR and MR/85 zones; and on lots zoned HR; and
- In the Dravus neighborhood on lots zoned SM/D/40-85.

Boston

Background

Boston instituted its first mandatory inclusionary housing program in 2000. The program, referred to as the Inclusionary Development Policy (IDP), is based on a series of Mayoral Executive Orders and clarifying regulations adopted by the Boston Redevelopment Authority (BRA). Since its inception, there have been eight major program or policy changes, most recently occurring in December of 2015 with the most recent Mayoral Executive Order and Boston Redevelopment Authority regulations.

Boston's IDP Base Requirement

The updated policy requires that 13-percent of total units on-site be affordable housing units. This requirement applies to all developments of ten or more units that also satisfy one of the following three conditions: built on public land, built using City funding, or requiring zoning relief. The regulations further define zoning relief as requiring any zoning variance, conditional use permit, exception, special development plan or other relief granted by the City's Zoning Commission. The only exceptions to this requirement are developments that are at least 40-percent affordable, dormitories and other conditions as specified by the zoning code.

Anywhere in the City, a developer may satisfy their required IDP units through the 13-percent on-site requirement. Developers can also elect to make an 'IDP Contribution' or build units off-site as well but must follow different requirements based on their location in one of three zones in the City. These zones represent tertiles of sales prices and are supposed to reflect the heterogeneity of market conditions throughout the City. In general, requirements for developments in Zone A have the highest required contributions and strictest rules, Zone B less so, and developments in Zone C have the lowest requirements and most flexibility.

Ownership developments must make half of the required 13-percent of units affordable to buyers earning less than or equal to 80-percent AMI and half to buyers earning between 80-percent AMI and 100-percent AMI. For rental developments, the IDP units must be affordable to tenants earning less than or equal to 70-percent AMI. However, projects in Zone C may apply to staff to make units affordable to tenants at the 100-percent AMI level if the project would be otherwise infeasible. A micro-units affordable rent is calculated as 90-percent of a studio's affordable rent. Micro-units are studios of less than 450 ft².

Quality and Location

City-wide, the IDP sets forth requirements around the quality and location of housing provided. IDP units must be comparable in size, bedroom count, and quality to market rate units as well as meet or exceed all BRA construction guidelines. Developers may apply for an exception to these quality requirements if they can demonstrate substantially higher housing outcomes. Otherwise, the units must contain a comparable bedroom count, quality of finishes and square footage. Off-site units must include the same or a greater

percentage of two bedroom or larger units compared to the market rate units.

The IDP program seeks to encourage economic integration by requiring that IDP units be distributed throughout the market rate building when built on-site. They cannot be concentrated in one floor or stacked onto the same side of a building. For the off-site option, units must be 'in the vicinity' defined as within a half mile of development unless a waiver is approved by staff. All units are also intended to be made affordable for the longest period of time possible. Currently, the BRA requires 30 year deed restrictions initially that include an option for the BRA for a 20 year renewal. These requirements apply equally to rental and ownership housing, and regulations specifically forbid renting out IDP units designated as affordable ownership units.

Satisfying the In-Lieu Options

Developers seeking to satisfy their IDP requirement without building units on-site, or in addition to some on-site units may pay a fee or build units off-site depending on their location in the City. Only projects delivering ownership housing in Zone A may pay the in-lieu fee by right. All rental projects and ownership projects in Zones B and C must request approval from staff for the option of paying the in-lieu fee. All developments except those in Zone C may build off-site units by right to satisfy their obligation. Developments in Zone C must request approval from Staff. Development's straddling zones have the more stringent requirements applied.

The IDP also imposes a few additional regulatory details on in-lieu contributions. Any fractional unit requirement of .5 or above is rounded up to the nearest unit while a smaller fractional unit requires an in-lieu fee payment. Off-site units may not use other competitive affordable housing funds unless authorized by staff. Off-site units must also obtain their building permits by the time the market rate project receives its certificate of occupancy. In addition, the IDP development must have a certificate of occupancy within a year of the market rate project's completion. These off-site units may be either built new or rehabilitated.

Developers may pay their in-lieu fee based on the following schedule:

Table 3: Boston In-Lieu Fee Schedule

	Zone A	Zone B	
Rental	18% of total units X \$380,000	18% of total units X \$300,000	15% c
Ownership	18% of total units by the greater of: \$380,000, or Half the difference between the market rate unit's price and it's affordable price	18% of total units by the greater of: \$300,000, or Half the difference between the market rate unit's price and it's affordable price	15% c of: \$200,(Half th marke afforde

Affordable sales prices are defined annually by the BRA. Developers have the option to request that their in-lieu fee be targeted towards a particular project if the project meets BRA standards. Payment schedules differ for homeownership and rental developments. Rental development must pay the fee associated with any fractional units within 30 days of receiving their building permit. After that, payments are due in equal installments over the next seven years on the anniversary of the building permit issuance. Developers may opt to pay the present value of the entire sum up-front as calculated by the most recent 10 year treasury yield. Homeownership projects must pay a quarter of their total expected contribution within 30 days of receiving their building permit. They must pay the remainder within 30 days of the issuance of the certificate of occupancy. Within the next one or two years, BRA then determines the average sale price was for the market rate units and recalculates the exact in-lieu fee. Developers are responsible for any remaining payments within 30 days of final invoice.

New York City

Background

New York City added a mandatory inclusionary housing (MIH) program to its two voluntary inclusionary housing programs in March of 2016. The program's legal foundation rests in the City's Zoning Resolution in Section 23-154 Section D. The program was justified through two extensive studies. The NYC Department of Planning completed a large study of the demographic and economic justifications for pursuing greater economic integration through a number of housing policies including an inclusionary housing policy. BAE Urban Economics completed a detailed analysis to evaluate the impacts that various inclusionary housing policy permutations would have on the financial feasibility of new, market-rate residential development.

Base Requirement

The MIH requirements apply to larger residential developments, enlargements or conversions in certain residentially zoned areas of the City. The current list of areas and accompanying maps can be found in Appendix F of the Zoning Resolution. Generally speaking, the zones have higher residential density limits and are scattered throughout the City. Projects only trigger the MIH requirement if they are equal to or larger than 10 units and 12,500 square feet of residential floor area. Projects are exempt if they only include affordable senior residences. The enabling resolution also provides for an appeals process for developments that believe the MIH requirements render a project financially infeasible. Section 73-624 stipulates how the Board of Standards and Appeals may modify the MIH requirements on a case by case basis.

Developers may satisfy their on-site obligation by providing a percentage of the total number of housing units as affordable units using one of two options. In Option 1, developers provide 25-percent of the total units in the project as affordable to households earning less than 60-percent AMI with at least 10-percent of the total units reserved for households earning less than

40-percent AMI. In Option 2, developers provide 30-percent of the total units in the project as affordable to households earning less than 80-percent AMI. There are also two additional options that may be available to use in conjunction with either Option 1 or 2. The Deep Affordability Option requires developers to provide 20-percent of the total building as affordable to households earning less than 40-percent AMI. This option also precludes developers from accessing any other forms of affordable housing funding. The Workforce Option requires 30-percent of the total units to be available to households that, on average, earn less than 115-percent AMI. The Workforce Option also requires that 5-percent of units be affordable to households in the 60-70-percent AMI range and 5-percent of units be made available to households in the 80-90-percent AMI. In addition, no household in the Workforce Option may earn more than 135-percent AMI.

The City Council decides as a part of the rezoning process which options are appropriate for which areas that are being upzoned and included in the MIH program. The Workforce and Deep Affordability Options must be matched with one of the two main options. If the Workforce Option is selected, it will sunset after 10 years unless reauthorized by the City Council. It can also not be selected for development within the Manhattan Core.

Units provided under the MIH program must conform to a number of other requirements. The affordability restrictions do not expire. Amenities in the building must be made available to all units and all units must share the same entrance. Finally, the affordable units must be distributed throughout the building on minimum of 65-percent of the floors of the building.

Developers also have the option by-right to satisfy the MIH requirement by contributing to the Affordable Housing Fund if their development is less than or equal to 25 new units and a 25,000 square feet increase in residential floor space. The fee is set annually by staff to be equal to the cost of developing a unit in the same Community District.