

Multicity Affordable Housing Nexus and Impact Fee Feasibility Study

Proposed Work Plan

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Prepared for:
City of Foster City and
21 Elements



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I. PROPOSED SCOPE OF WORK

The following scope is designed to meet the objectives of the 21 Elements jurisdictions as outlined in the request for proposals. Except where noted, the tasks as presented are applicable to three potential city groups:

- Group 1 includes those San Mateo jurisdictions participating in the residential nexus study (with the exceptions of Daly City, San Carlos, and East Palo Alto as outlined in the RFP) and those San Mateo jurisdictions participating in the commercial linkage nexus studies (with the exceptions of San Mateo County, Hillsborough, Atherton, Portola Valley, Woodside, Half Moon Bay, and Pacifica).
- Group 2 includes commercial nexus studies for Foster City, Menlo Park, San Mateo City and South San Francisco as well as residential nexus studies for Burlingame, Menlo Park, San Bruno, and the City of San Mateo.
- Group 3 includes residential and commercial nexus studies for Palo Alto.

In accordance with the RFP and instructions on its preparation this proposal includes three budgets, one for each of the groups described above. In the task list below, we have slightly reordered tasks, so that the residential nexus studies are completed prior to the commercial nexus studies. In addition, because we understand that priorities may shift depending on funding availability and other concerns, we have included several optional tasks in the scope.

Task 1. Project Initiation

1.1. Review of Background Materials

The Strategic Economics/VWA team will review background information provided by 21 Elements staff on the demographics and housing conditions in San Mateo County. In addition, we will review the East Palo Alto and San Carlos nexus studies.

1.2. Kickoff Meeting

The Strategic Economics/VWA team will attend a kickoff meeting with Baird + Driskell Community Planning and participating 21 Elements jurisdictions. This meeting will be convened by Baird + Driskell. The purpose of this meeting is to finalize the scope of work and schedule, review the proposed methodologies, and obtain any additional background materials or key information. The Strategic Economics/VWA team will provide an agenda in advance of the meeting.

Deliverable: Revised scope (if necessary), and project schedule with milestones.

Task 2. Affordability Gap

While Baird + Driskell has calculated affordability gaps for both renters and owners in all 21 Elements jurisdictions, we will want to review the methodology and likely change some of the assumptions. For example, it appears that utility payments are not included in the rental gap calculations, and they are routinely included for the purpose of a nexus study. Also, in the table provided for the for-sale gap calculation, there are no multifamily, for-sale units included. Finally, we would need to expand the table to include additional household sizes.

The methodology we routinely use for the gap calculation is as follows:

- Calculate affordable rents and sales prices for income groups to be served under each city's program based on U.S. Department of Housing and Urban Development (HUD) or California Department of Housing and Community Development incomes for San Mateo County for various household sizes.
- Calculate housing affordability gap for ownership housing, based on the difference between the cost of developing a new modest, residential unit (of the appropriate size for the household) and the amount a household can afford to pay at various income levels and household sizes.
- Calculate housing affordability gap for rental housing based on the difference between the annual capitalized value of the net affordable rent and the annual amortized mortgage payment needed to fund the new rental unit. Again, separate calculations are made for each income group and household size included in the gap analysis.

Affordable rents and sales prices would be defined using standard methods used by state or local programs. We will use the information provided by Baird + Driskell and expand upon it for use in this study.

Deliverable: Concise technical memorandum containing draft tables summarizing the affordable housing gap for renters and owners.

Task 3. Residential Nexus Study

The purpose of this task is to estimate the increase in demand for affordable housing associated with growth in new residential development. The primary driver for this increase in demand for affordable housing is the growth in expenditures for goods and services attributable to buyers and renters of new market rate housing units in the 21 Elements jurisdictions that are included in the study, as well as in Palo Alto. (Palo Alto is included as an optional task).

Task 3.1. Residential Market Overview

Prior to beginning this task, we will distribute a data request through 21 Elements staff regarding what types of housing developments are currently being built or in the pipeline in each jurisdiction. This information allows us to define the residential prototypes to include in the study. Since prototypes vary by size, rents and sales prices, it is important to estimate separate housing impact fees for each housing prototype. While we will consider whether there are similarities in these prototypes across jurisdictions (including sales prices and rents), it is important that these prototypes reflect actual market conditions in each jurisdiction. This scope covers selection of up to four residential prototypes covering both rental and ownership housing in each jurisdiction.

Task 3.2. Nexus Analysis

It is assumed that an increase in household expenditures associated with new housing units results in employment growth. Some of these new employees can afford market rate housing (based on household income), and some will earn incomes below the level needed to afford market rate housing. It is this second group of employee-households that will experience negative housing impacts, if they want to work and live in the same city.

The analytical steps required for this computation are the same for both rental and ownership housing with one exception. Annual gross rents are used to estimate household incomes of future renters moving into new rental properties, whereas sales prices are used to estimate household incomes of future buyers of new units.

The list below provides a walk-through of the analytic steps involved to move from estimating new residential development to estimating the demand for affordable housing. This analysis answers the question, “What is the maximum impact fee that can be charged?” This analysis does not address “At what level should the housing impact fee be set?” This second question is addressed in Task 3.3.

Analytical Steps to Estimate Affordable Housing Impacts from New Ownership and Rental Housing Developments

1. Create a list of sales prices of newly built housing units that were sold in 2011, 2012, and 2013 for each of the ownership prototypes. Determine rents charged in new rental developments built between 2011 and 2013 for all unit sizes.
2. Estimate household income distribution of new buyers of each housing prototype in each jurisdiction by calculating incomes required to purchase new housing, based on conventional lending standards. For new rental housing, gross annual rents provide the information needed to estimate renters’ income distribution.
3. Compute total consumer expenditures on goods and services of the new households in each jurisdiction. This figure is derived from inputting household incomes calculated in Step 2 into the IMPLAN economic analysis model. Separate models will be developed for each prototype.
4. Through the use of zip code level information from the IMPLAN model for San Mateo and Santa Clara Counties, it is possible to estimate the number of new employees in each jurisdiction that are needed to accommodate the increase in economic activity defined in Step 3.
5. Adjust growth in employment by the percentage of new employees who would want to work and live in the same jurisdiction. Selecting the percentage of new employees who would want to live and work in each jurisdiction is a policy decision and not a strictly analytical one. For example, each jurisdiction could continue with the status quo (only a percentage of new employees in each city will also live in the same city), or it could decide to provide for all affordable housing needs generated by new employment within its boundaries, or it could take a mid-position between these two options. This is another issue to discuss at project initiation.
6. Calculate the number of households represented by these new employees. This adjustment is based on the average number of wage earners per household in each jurisdiction provided by the most recent census.
7. Estimate employee incomes by using the average wage by occupation for all occupations comprising each detailed industry sector analyzed. This information can be obtained from the California Labor Market Information Division.
8. Convert employee income to household income in order to adjust for multiple wage earners in households.
9. The next step provides a count by income level of new employee households that will move to each jurisdiction to provide goods and services to new homeowners and renters. Only some of these households will require affordable housing. The income cut-off can be based on policy priorities for each jurisdiction. For example, one city could select a level of 50 percent area median income (AMI) as the cut-off, another could select 80 percent AMI, and yet another could select up to 120 percent AMI. The selected income cut-off should be consistent with the income cut-off used in the Affordability Gap Analysis (Task 2).
10. For each prototype, the number of households requiring affordable housing is then multiplied by the average housing affordability gap (calculated separately for renters and owners in Task 2). This total amount is then divided by the number of units in each prototype to derive a maximum housing impact fee per unit.

Task 3.3. Policy Considerations

The fee calculated under Task 3.2 represents the maximum fee that can be levied on new residential units. Selecting the actual fee requires sensitivity to local conditions. Factors to consider when selecting the actual fee level are presented below.

Fees Charged in Neighboring Jurisdictions. It is standard practice to consider the fee levels and requirements of neighboring jurisdictions. To the extent possible, we will try to compare proposed fees with housing impact fees currently charged in some cities in San Mateo and Santa Clara Counties. We will also note how the fees are calculated and how recently a fee study had been completed in each jurisdiction.

Financial Feasibility of Potential Fee Levels. There are multiple ways to assess financial feasibility of potential fee levels:

- Assess how much a jurisdiction's total residential impact fees will increase under the new fee requirements. Is there a significant increase? What will be the impact on profitability of adopting the maximum justified fee? What if the fees were less than the maximum that is justified through the nexus study? To answer these questions, we will create development cost pro forma models for each prototype, based on general cost category assumptions and assess results.
- Interviews/focus groups with local developers will be helpful in understanding how they view the imposition of new fees to replace inclusionary requirements. Again, several fee levels will be considered, including both the maximum and lesser amounts. This would occur as part of optional task 8 in the budget.

Other Policy Considerations. In addition to the nexus findings, this task will also examine the following three policy considerations for inclusion in the draft and final reports:

- *Establishing Inclusionary Percentages Based on Nexus Analysis.* A residential nexus study can also be used to establish the percentage of inclusionary units, if inclusionary zoning is still an option for jurisdictions included in this study. The number of employee households that require affordable housing (for each prototype) is divided by the number of units in the prototype to generate a percentage of affordable housing units required in a market rate development. This number may be higher or lower than the current inclusionary percentage required in a jurisdiction.
- *Benefits of Providing Affordable Housing.* This discussion can be included in the fee recommendation section or later in the summary report. The main advantage to new market rate residential development from a housing impact fee is to increase the number of local workers who can afford to live in the same jurisdiction as their jobs. This is particularly important for public sector employees, such as teachers and public safety workers. Highlighting the advantages of increasing the supply of affordable housing to the general community can help gain support for a new residential impact fee.
- *Unit Sizes and Exclusions.* Additional policy issues to consider for the residential housing impact fee include whether to exclude units below a certain size (on the assumption that smaller market rate units are more affordable), charging a lower fee per square foot for smaller units and the full fee for larger units, or starting with a lower fee amount and phasing in the fee over a period of time, if there is concern about current market conditions.

Task 3.4. Fee Recommendation

Based on Tasks 3.2 and 3.3, the Strategic Economics/VWA team will recommend fee levels for all jurisdictions included in the study. Then, during the public process described in the optional task section below, these fees will be presented to stakeholders and public officials to elicit feedback. Included in the

fee recommendation will be an estimate of the number of affordable housing units that can be built (based on fees from each prototype), and assuming additional sources of financing routinely accessed by affordable housing developers.

Task 3.5. Updating the Fees

Similar to any impact fee, it will be necessary to adjust the residential impact fee on an annual basis. Adjustments are also needed due to possible changes in the affordability gap. However, the connection between new residential construction and growth in employment derived from the IMPLAN model is unlikely to change in the short run.

It is advisable that the jurisdictions adjust their housing impact fees by using an annual adjustment mechanism. An adjustment mechanism updates the fees to compensate for inflation in development costs. To simplify annual adjustments, it is recommended that a jurisdiction selects a cost index that is routinely published. There are at least two options to consider:

- The first option is the Consumer Price Index (CPI) for shelter. The shelter component covers costs for rent of primary residence, lodging away from home, owners' equivalent rent of primary residence, and household insurance. Of the total shelter index, costs associated with the owners' equivalent rent of primary residence constitute 70 percent of total costs entered into the index.
- A second option to adjust the fee for annual inflation is the construction cost index published in the Engineering News Record (ENR). This index is routinely used to update other types of impact fees. Cost index information for the San Francisco area is available on an annual basis. While this index measures inflation in construction costs, it does not incorporate changes in land costs and public fees charged on new development. However, several jurisdictions use the ENR index to adjust housing impact fees.

Deliverables: Technical memorandum on housing fees with summary tables. Information from several subtasks will be used in the draft and final reports. Also, a draft methodology appendix will be provided to staff.

Task 4. Commercial Nexus Study

The purpose of a Commercial Linkage Fee Nexus Study is to quantify the increase in demand for affordable housing that accompanies new non-residential development. It is assumed that there will be a net gain in employment when new commercial space is built. The ability of new employees to pay for housing costs is linked to their occupations (and hence salaries). Additional housing units will be needed for those employees who both work and live in one of the 21 Elements jurisdictions that are included in the study, as well as in Palo Alto.

Housing units at all price levels are needed. Given anticipated incomes, there may be an affordability "gap" between what some households can afford to pay (to rent or to buy) and the actual costs of new development. This "gap" provides the basis for a fee calculation.

Task 4.1. Commercial Market Overview

Prior to beginning this task, we will distribute a data request through 21 Elements staff regarding what types of commercial developments are currently under construction or in the pipeline. This information allows us to define the commercial prototypes to include in the study. Since prototypes vary by size and intended use, e.g., office, retail, or industrial, it is important to estimate separate commercial linkage fees for each prototype. While we will consider whether there are similarities in these prototypes across jurisdictions, it is important that these prototypes reflect actual market conditions in each jurisdiction. This scope covers selection of up to three commercial prototypes to be selected in conjunction with staff.

Task 4.2. Nexus Analysis

The first step of the nexus analysis is to calculate the number of employees that will work in the new space, the number of new households associated with this employment growth, and the number of these households expected to live in each jurisdiction. The second step is to estimate the incomes of the new employee-households. The third step is to estimate the number of households that will need affordable housing. These calculations will be undertaken separately for each land use as shown below:

Analytical Steps to Estimate Affordable Housing Impacts from New Commercial Developments

1. Select commercial prototypes, such as office, technology, retail, and hotel. The goal is to develop separate linkage fees for each development type for each jurisdiction. Develop a prototype project size for each development type.
2. Select appropriate employment density factors for each prototype. Employment density is defined as the number of square feet of space per employee.
3. Calculate the number of employees who will work in the new space of each development prototype by dividing total project size by the relevant employee density figure.
4. Estimate the number of new employees who will move to the jurisdiction in order to work in the new jobs. The percentage of new employees that will move to one of the jurisdictions would be the same as the percentage defined for the Residential Nexus Study (see above).
5. Calculate the number of households represented by these new employees. This adjustment is based on dividing growth in employment by the average number of wage earners per household in each jurisdiction provided by the most recent census.
6. Estimate employee incomes by using the average wage by occupation for all employees likely to work in the newly developed commercial space. Since new space will employ workers in a range of occupations, an average income for each commercial development type will be calculated. (Wage information can be obtained from the California Labor Market Information Division.)
7. Convert employee income to household income in order to adjust for multiple wage earners in households.
8. Determine the number of new employee-households at or below the household income threshold that applies to the program. It should be consistent with the income cut-off used in the Affordability Gap Analysis (and the residential nexus study).
9. The number of households requiring affordable housing is then multiplied by the average affordable housing gap figure. This aggregate sum is then divided by the size of each prototype to generate an impact fee per square foot. This calculation is performed separately for each commercial prototype. For mixed use projects, the fee would be pro-rated based on projected land uses. These fees represent the maximum that can be charged.

Task 4.3. Policy Considerations

The fee calculated under Task 4.2 represents the maximum fee that can be levied on new commercial developments. Selecting the actual fee requires sensitivity to local conditions. Factors to consider when selecting the actual fee level are presented here.

Fees Charged in Neighboring Jurisdictions. It is standard practice to consider the fee levels and requirements of neighboring jurisdictions. To the extent possible, we will try to compare proposed fees with commercial linkage fees currently charged in some cities in San Mateo and Santa Clara Counties.

We will also note how the fees are calculated and how recently a fee study had been completed in each jurisdiction to establish those fees.

Financial Feasibility of Potential Fee Levels. There are several ways to assess financial feasibility of potential fee levels:

- Assess how much the imposition of a commercial linkage fee will add to commercial fees currently charged in each jurisdiction. Is there a significant increase? What will be the impact on profitability of adopting the fully justified fee? What if the fees were less than the maximum that is justified through the nexus study? To answer these questions, we will create development cost pro forma models for each prototype, based on general cost category assumptions and assess results.
- Interviews/focus groups with local developers will be helpful in understanding how they view the imposition of new fees or expanded fees. Again, several fee levels will be considered, including both the maximum and lesser amounts. This would occur as part of optional task 8 in the budget.

Other Policy Considerations. In addition to the nexus findings, this task will also examine the following two policy considerations for inclusion in the draft and final reports:

- *Establishing Equivalencies to Payment of Fees.* A nexus study establishes the amount of funds that are necessary to mitigate impacts on affordable housing demand from new development. If a developer prefers to build the housing or deed land to a developer that will build affordable housing, it is necessary to establish a process for determining the value of in-kind payment. Since land values are dynamic, the study can identify how to estimate the equivalency, but not actually provide the equivalency in the body of the report.
- *Benefits of Providing Affordable Housing.* This discussion can be included in the fee recommendation section or later in the summary report. The main advantage to new commercial development from a commercial linkage impact fee is to increase the number of local workers who can afford to live in the same jurisdiction as their jobs. The advantages of increasing the supply of affordable housing to the general community can help gain support for a new or expanded commercial linkage impact fee program.

Task 4.4. Fee Recommendation

Based on Tasks 4.2 and 4.3, the Strategic Economics/VWA team will recommend fee levels for all jurisdictions included in the study. Then, during the public process described in the optional task section below, these fees will be presented to stakeholders and public officials to elicit feedback. Included in the fee recommendation will be an estimate of the number of affordable housing units that can be built (based on fees from each prototype), and assuming additional sources of financing routinely accessed by affordable housing developers.

Task 4.5. Updating the Fees

Similar to any impact fee, it will be necessary to adjust the commercial linkage impact fee on an annual basis. Adjustments are also needed due to possible changes in the affordability gap. It is advisable that the jurisdictions adjust their commercial linkage impact fees by using an annual adjustment mechanism. An adjustment mechanism updates the fees to compensate for inflation in development costs.

To simplify annual adjustments, it is recommended that a jurisdiction selects a cost index that is routinely published. Two options are discussed under Task 3.5.

Deliverables: Technical Memorandum on Commercial Linkage Impact Fees with Summary Tables. Information from several subtasks will be used in the draft and final reports. Also, a Methodology Appendix will be provided to staff.

Task 5. Meeting with 21 Elements Staff and Stakeholders

Once the Strategic Economics/VWA team has conducted the nexus analyses and calculated the recommended fee levels for both commercial and residential development, the team will meet with the 21 Elements jurisdiction staff, Baird + Driskell, and stakeholders to discuss the initial findings and recommendations. It is assumed that the consultant team will attend two separate meetings (one with city staff and one with stakeholders) to be held on the same day. The meetings will be organized by 21 Elements staff and/or Baird + Driskell. The Strategic Economics/VWA team will prepare materials for and conduct the meetings.

Task 6. Prepare Draft and Final Reports

Task 6.1. Sample report

The Strategic Economics/VWA team will prepare a sample representative nexus study for both residential and commercial development for one of the cities. The draft report will provide the basis and methodology for establishment of an affordable housing impact fee for both commercial and residential development that is consistent with the requirements of state law. The report will discuss the following:

- Current trends in affordable housing finance will be presented. (This section will basically be the same for all jurisdictions.)
- Relative merits of expressing the residential impact fee on a per-unit or per-square foot basis for residential development. (Note: The primary recommendation for a commercial fee will be on a per square foot basis.)
- Information on the maximum fee as well as the recommended fees (rental and ownership housing impact fees and commercial linkage impact fees) will be provided and compared with housing impact and commercial linkage fees in other Bay Area cities, focusing on San Mateo and Santa Clara examples.
- Discussion of current development trends and expected future development patterns. Based on this information, estimates of revenue that could be collected based on pipeline projects will be provided.
- This revenue will be translated to the number of affordable housing units that could be built, assuming leveraging from other sources.

This sample report will be the model for the nexus study reports for all other participating cities and the county.

Task 6.2. Draft Nexus Reports

Once the team has received approval on format and structure of the sample report, it will complete drafts for all relevant 21 Elements jurisdictions.

Task 6.3. Final Reports for Cities and San Mateo County

Upon receipt of one consolidated set of comments, the Strategic Economics/VWA team will finalize the reports.

Task 6.4. Summary Report

The Strategic Economics/VWA team will prepare a draft report that summarizes the methodology and results of the study. The summary report will be relatively short, and will distill the information presented in the full nexus reports into a format that is user-friendly and easily understood by a wide audience. Based on one consolidated set of comments the team will finalize the summary report.

Deliverables: Sample nexus study report, draft nexus reports and final nexus reports for all relevant jurisdictions. Draft and final summary report. All work products to be delivered electronically.

Task 7. Meeting with 21 Elements Staff

Upon submission of the draft reports, the Strategic Economics/VWA team will meet with the 21 Elements jurisdiction staff and Baird + Driskell to discuss findings, recommendations, and the public process needed to adopt the recommended fees.

Optional Tasks

Because of the limited budget available for this assignment, the Strategic Economics/VWA team has included the following items as optional tasks that could be provided to individual jurisdictions. Due to the uncertainty about which of the jurisdictions will opt to participate in these tasks, the work for these optional items will be provided either on a time and expenses basis, or through a supplemental fixed-fee contract.

Optional Task 8. Attend Public Hearings

Under this optional task the Strategic Economics/VWA team will present the results of the study at public hearings for specific jurisdictions.

Deliverable: PowerPoint presentations for public hearings.

Optional Task 9. Jurisdiction Specific Recommendations

Under this optional task the Strategic Economics/VWA team will provide additional support to specific jurisdictions requesting assistance. This support may include conducting interviews/ focus groups with developers and affordable housing stakeholders, and conducting workshops with public officials. The assistance will be provided as needed on a time and materials basis, or through a supplemental contract.

Deliverable: As scoped.

Optional Task 10. Develop Excel Workbook

In some situations, jurisdictions request the models that are used for impact fee studies, so that they can modify assumptions at a later date. Development of these workbooks requires additional effort beyond that needed to undertake calculations. If any jurisdiction is interested in this possibility, the Strategic Economics/VWA team can provide a separate budget for this work.

Deliverable: Excel workbook that can be used by city staff to update fees and examine alternate fee scenarios.

Optional Task 11. Palo Alto Study

This optional task includes conducting a residential and commercial nexus study for Palo Alto, as described under Tasks 1 through 4, above, and including a draft and final report and meeting with city staff to discuss the findings. Because Palo Alto is located in Santa Clara County and is not a 21 Elements community, the study will require additional analysis and data collection beyond the scope of work described above for the San Mateo County communities. Therefore, the Strategic Economics/VWA team has provided a separate budget for this study (Budget 3). Not included in this budget are optional tasks 8, 9, and 10.

Deliverable: Draft and final nexus reports for Palo Alto.