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# FINAL TECHNICAL REPORT

# SANTA ROSA INCLUSIONARY HOUSING IN-LIEU FEE ANALYSIS

Prepared for:

City of Santa Rosa

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# I. EXECUTIVE SUMMARY

The City of Santa Rosa as the result of ongoing policy review seeks to update the affordable housing in-lieu provisions of its Housing Allocation Plan. This Technical Report provides the technical analysis of the in-lieu fee program and estimates the fee necessary to achieve the 20 percent affordable housing inclusionary requirement. The former in-lieu fee of $2,600 per market rate unit was based on the City's Inclusionary Housing Policy making 20 percent of all new residential units affordable to low- and very low-income households. This fee was determined to be considerably lower than the actual cost of providing housing to lower income families, due largely to rising land and construction costs throughout Sonoma County, thus it did not assure that the 20 percent affordable policy could be met.

In July 2001, the City Council voted to increase its Inclusionary Housing In-Lieu Fee to $9,707 for an interim period as a result of preliminary findings indicating sufficient nexus to support a fee of between $9,694 and $15,889 per residential unit.[1] At that time, the Council expressed an interest in exploring alternate methods of implementing the in-lieu fee, and for addressing the full affordable housing need identified by the Association of Bay Area Governments' (ABAG) *Regional Housing Needs Determination*. EPS prepared a preliminary evaluation of four alternative fee structures, and found sufficient nexus to support a fee of up to $15,889 per unit, $1.95 per lot square foot, $4.63 per building square foot, and $0.04 per dollar of market value, based on meeting the RHND allocation of affordable housing. In December of last year, the City Council elected to implement the in-lieu fee based on the building size of new market-rate housing, and indicated support for a fee of $4.63 per square foot of new market-rate residential units, as estimated in the preliminary analysis.

In the process of completing the in-lieu fee analysis and producing this Technical Report, EPS worked with the City's Community Development Department to refine assumptions related to the number of vacant residential acres Citywide by density category, the anticipated density of new development, and the average number of building square feet per residential unit, as described in **Appendix A**. These and other adjustments to the in-lieu fee analysis indicate that sufficient nexus exists to warrant an in-lieu fee of up to $7.88 per building square foot of new market-rate units.

[1] The fee of $9,694 is based upon an inclusionary set aside policy of 20 percent, as described in the City's *Housing Allocation Plan*. The fee of $15,888 is based upon fully addressing the Association of Bay Area Government's *Regional Housing Needs Determination* for the City of Santa Rosa, which would require 33 percent of new residential units be set aside for affordable housing.

However, the City need not technically impose the maximum permissible fee. On the contrary, jurisdictions typically adopt fee amounts that are substantially less than the total amount justified by the strict nexus reflecting other sources of funding for affordable housing subsidies such as Federal tax credits and redevelopment funding. Thus, in light of the Council's earlier agreement to adopt an in-lieu fee amount of $4.63 per building square foot, and given that this amount is well within the maximum amount justified by the nexus analysis, the Council may adopt the in-lieu fee of $4.63 per building square foot of new market rate housing developed.

# II. INTRODUCTION

This Report provides the technical analysis necessary for the City of Santa Rosa to update the affordable housing in-lieu provisions of its Housing Allocation Plan. This update commissioned as a result of *A Housing Strategy Evaluation* (October 2000) which assessed the demand for affordable housing, calculated the financial gap between production costs and households' ability to pay, and evaluated the various programs and policies being considered as part of a solution to the affordable housing problem. Among other conclusions, the *Housing Strategy Evaluation* determined that the existing inclusionary policy and in-lieu fee amount was far below the actual cost of constructing the corresponding number of affordable units.[2]

Prior to August, 2001, the in-lieu fee for affordable housing was set at $2,600 per market-rate unit. This fee was calculated in 1995 by determining the average cost of subsidy for an affordable unit, and then dividing that figure by five, in reference to the percentage of total housing units in a project that was to be market rate (100 percent) not directly providing affordable units, versus the percentage that should be affordable (20 percent) in accordance with the Housing Allocation Plan. Two distinct policy alternatives were analyzed as part of this Technical Report, and are referenced throughout this Report:

- ***Alternative A*** is based upon the Association of Bay Area Governments' (ABAG) housing projections for the Santa Rosa Subregional Study Area through 2006, and assumes that 20 percent of new housing units will be made affordable to low- and very low-income households, in keeping with the policy set forth in the City's Housing Allocation Plan.

- ***Alternative B*** is based upon fully addressing ABAG's *Regional Housing Needs Determination*, which indicates that a total of 33 percent of all 7,654 new housing units expected through 2006 will be needed to meet the needs of low- and very low-income households.

For each Alternative described above, the costs associated with producing affordable housing was estimated, as was the gap between these costs and the ability of households to pay for housing. This Report sets forth the "nexus," or relationship, between residential development and the City's inclusionary housing policy, as well as the technical basis of the in-lieu fee option. Finally, a number of policy and economic considerations are identified that the City should take into account before officially adopting the updated in-lieu fee.

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[2] Assumes 20 percent inclusionary requirement, which is applicable to residential developments providing affordable housing off-site. Developers building affordable housing on-site are required to provide affordable units equal to 15 percent of total units.

## SUMMARY OF FINDINGS

The analysis performed for this Report indicates that the average difference between the cost of providing housing, and the ability of low- and very low-income families to pay for housing, is approximately $80,000 per unit. This funding gap has grown rapidly in recent years due to rising land and construction costs that have outpaced increases to the median household income of the area.

As described above, two policy alternatives were studied for the purpose of updating the Inclusionary Housing In-Lieu Fee. Implementation of Alternative A would result in a total net subsidy requirement of $70 million through 2006.[3] The in-lieu fee based on this subsidy requirement can be structured in a variety of ways, depending on the unit of measurement preferred by the City. For example, dividing the $70 million in subsidies required by the 7,654 new units anticipated in the City during that time period results in a per unit amount of $9,193. Alternately, the City could adopt an in-lieu fee of up to $1.03 per lot square foot, $4.56 per building square foot, or $0.02 per dollar of home sales price.

Implementation of Alternative B, on the other hand, can be expected to result in a total subsidy requirement of $122 million, or a maximum fee of $15,875 per unit, $1.77 per lot square foot, $7.88 per building square foot, and $0.03 per dollar of market value. These fees represent the maximum in-lieu fee amount that can be supported by the nexus analysis. The City can elect to adopt a fee that is lower than the nexus amount, but can not impose a fee which is higher than the amount justified by the nexus analysis.

## ASSUMPTIONS & METHODOLOGY

For the purpose of this analysis, a number of assumptions were made related to the cost of producing housing, the total number of housing units expected within the City, the portion that will be subjected to the fee requirement, the ratio "set aside" amount for affordable housing units, and the ability of low- and very low-income households to pay for housing. These assumptions are assembled in a series of tables that trace the in-lieu fee calculations. These tables, and the following discussion, document the total subsidy that would be required to provide affordable units as defined for Alternative A and Alternative B.

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[3] These calculations take into account other potential funding sources that can be used to address the affordable housing need within the City, including Federal and State tax credit programs.

# III. AFFORDABLE HOUSING NEED

## REGIONAL HOUSING CONTEXT

The City of Santa Rosa has experienced significant population and housing growth in recent years, and these trends are projected to continue in the decades to come. According to ABAG's *Projections 2000* data, the population in the City of Santa Rosa has grown from 123,700 in 1995 to 137,400 in 2000 -- a net increase of 13,700 in those five years. In the five-year span from 2000 to 2005, the population is expected to grow by an additional 12,700, representing a 9.2 percent increase over the current population. Further, according to ABAG's *Regional Housing Needs Determination*, 7,654 housing units will be required in Santa Rosa over the next five years to serve the needs of its growing residential population. Of this total, 2,509 units will be needed to meet demand from low- and very low-income households.

The rapid growth experienced in Santa Rosa and Sonoma County has resulted in increased housing demand and, consequently, higher housing prices. In fact, the market for residential uses throughout Sonoma County has expanded at a record pace. The Federal government reported last year that housing prices were rising faster in Sonoma County than any other place in America, at three times the rate found nationwide. For example, the median home value in the City of Santa Rosa rose from $162,250 in 1996 to $219,000 in 1999 — an increase of 35 percent in only three years. Housing prices are likely to continue escalating during the next few years, making housing affordability an increasingly difficult problem.

Although the local housing market has historically provided homes affordable to a wide range of income levels, recent trends have indicated that an increasingly large proportion of units are priced well beyond the means of lower- and moderate-income households, and fewer new and existing units are affordable for such households. Over time, this may result in the need to provide subsidies to moderate-income households as well as to the low- and very low-income households.

## HOUSING PRODUCTION COSTS

Perhaps the most important assumption for the in-lieu fee calculation is the estimate of housing production costs in the City of Santa Rosa. This information is necessary to calculate the subsidy that will be required to bridge the gap between the cost of providing housing and the ability of families to pay for that housing. Obviously, there is no single answer to this question; housing costs will vary with the home's size, type, price range, etc. However, EPS has developed assumptions of production costs for typical residential developments based on data provided by both private and nonprofit housing developers, as well as previous research pertaining to the local Sonoma County real estate market.

Cost estimates have been limited to "basic" units using typical prototypes for affordable housing projects that have been constructed in the County. This information indicates that production costs for single family units range from $121 to $161 per square foot, while the production of multi-family units ranges from $158 to $168 per unit, exclusive of developer profit. For this analysis, estimates of $141 per square foot for single family and $163 per square foot for multi-family homes were applied to four housing prototypes to arrive at the following housing costs: 1) a two-bedroom single family unit of 1,100 square feet at $155,224; 2) a three-bedroom single family unit of 1,350 square feet at $190,503; 3) a two-bedroom multi-family unit of 850 square feet at $139,000; and 4) a three-bedroom, multi-family unit of 1,100 square feet at $179,000.

## HOUSEHOLD AND INCOME ASSUMPTIONS

As described earlier, two policy alternatives were studied for the purpose of this analysis. Alternative A is based on making 20 percent of all new residential units affordable to low- and very low-income households. To calculate the total affordable housing subsidy requirements, it is assumed that 10 percent, or 765, of the total units required in Santa Rosa through 2006 shall be set aside for low-income households, and another 10 percent will be set aside for very low-income households, for a total of 1,530 affordable units, as shown in **Table 1A**.

Alternative B is based on addressing the full affordable housing need as identified in the *Regional Housing Needs Determination*. ABAG has identified a need for 7,654 housing units within the Santa Rosa Subregional Study Area (SSA) through 2006. Of this total, ABAG projects a need for 2,509 very low- and low-income units over the same time period (**Table 1B**).

As shown in **Table 2**, the median income in Santa Rosa is $55,600 for a three-person family and $61,800 for a four-person family, based upon updates provided by the California Department of Housing and Community Development (HCD) in April, 2001. For the purposes of calculating housing affordability, HCD assumes low-income families have a household income equal to 70 percent of median for owner-occupied housing and 60 percent of median for rental housing. Thus, it is assumed that a low-income household purchasing a home may earn $38,900 or less for a three-person family, and $43,300 or less for a four-person family. For rental units, it is assumed that the low-income household earns $33,400 for a three-person family and $37,000 for a four-person family. Very low-income families are defined as those earning 50 percent of median income for both owner-occupied and rental units, resulting in income estimates of $27,850 for three-person families, and $30,900 for four-person families.

**Table 1A**
**Allocation of Housing Units: Alternative A**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Unit Type | Allocation of Housing by Income | Distribution of All New Units by Income | Distribution of Affordable Housing Units | | | |
|---|---|---|---|---|---|---|
| | | | Single Family Units | | Multi Family Units | |
| | | | 3-Person 2-Beds | 4-Person 3-Beds | 3-Person 2-Beds | 4-Person 3-Beds |
| **Above Moderate Income** | 40% | 3,182 | 0 | 0 | 0 | 0 |
| **Moderate Income** | 40% | 3,182 | 0 | 0 | 0 | 0 |
| **Low Income** (1) | 10% | 765 | 192 | 191 | 191 | 191 |
| **Very Low Income** (2) | 10% | 765 | 0 | 0 | 382 | 383 |
| **Total Units** | 100% | 7,654 | 192 | 191 | 573 | 574 |

(1) Assumes half of low income households will reside in multi-family units and half will reside in single family units.
Assumes that low income households are equally divided among 3- and 4-person households.
(2) Assumes that all very low income households will reside in multi-family units.

Sources: ABAG; HUD; Economic & Planning Systems, Inc.

**Table 1B**
**Allocation of Housing Units: Alternative B**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Unit Type | Allocation of Housing by Income | Distribution of All New Units by Income | Distribution of Affordable Housing Units | | | |
|---|---|---|---|---|---|---|
| | | | Single Family Units | | Multi Family Units | |
| | | | 3-Person 2-Beds | 4-Person 3-Beds | 3-Person 2-Beds | 4-Person 3-Beds |
| **Above Moderate Income** | 40% | 3,025 | 0 | 0 | 0 | 0 |
| **Moderate Income** | 28% | 2,120 | 0 | 0 | 0 | 0 |
| **Low Income** (1) | 13% | 970 | 243 | 243 | 242 | 242 |
| **Very Low Income** (2) | 20% | 1,539 | 0 | 0 | 770 | 770 |
| **Total Units** | 100% | 7,654 | 243 | 243 | 1012 | 1012 |

(1) Assumes half of low income households will reside in multi-family units and half will reside in single family units.
Assumes that low income households are equally divided among 3- and 4-person households.
(2) Assumes that all very low income households will reside in multi-family units.

Sources: ABAG; HUD; Economic & Planning Systems, Inc.

**Table 2**
**Income Limits by Affordable Housing Category**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Unit Type | Assumed Percent of Median (1) Owner | Assumed Percent of Median (1) Rental | Owner-Occupied Housing 3-Person Household (2) | Owner-Occupied Housing 4-Person Household (3) | Rental Housing 3-Person Household (2) | Rental Housing 4-Person Household (3) |
|---|---|---|---|---|---|---|
| **Moderate Income** | 110% | 110% | $61,160 | $67,980 | $61,160 | $67,980 |
| **Low Income** | 70% | 60% | $38,920 | $43,260 | $33,360 | $37,080 |
| **Very Low Income** | 50% | 50% | $27,800 | $30,900 | $27,800 | $30,900 |

(1) To calculate housing affordability for owner-occupied units, HCD uses 50% of median for very low income households, 70% of median for low income, and 110% of median for moderate income households. For rental units, the assumed percent of median is 50%, 60%, and 110% respectively.
(2) 2001 HCD Income limits define Sonoma County median income for 3-person household as $55,600.
(3) 2001 HCD Income limits define Sonoma County median income for 4-person household as $61,800.

Sources: HCD; Economic & Planning Systems, Inc.

## ESTIMATE OF ABILITY TO PAY

The income limits outlined above were used to determine the ability of low- and very low-income households to pay for both single and multi-family housing. Assuming a mortgage-to-income ratio of 0.35 and a 10 percent down payment, moderate-income households can afford a home value of up to $255,000 for three-person families, and $287,000 for four-person families. Assuming a mortgage-to-income ratio of 0.30 and a 10 percent down payment, low-income households can afford home prices of $122,000 and $140,000 for three- and four-person families respectively, while very low-income households can afford to pay $77,000 for three-person families and $90,000 for four-person families. This information is summarized in **Table 3**.

For purposes of comparison, the ability to pay for multi-family units is also expressed in terms of affordable home value in addition to maximum monthly rent. For example, assuming a rent-to-income ratio of 0.30 per HCD guidelines, a moderate-income family of three can afford a monthly rent of $1,179, as shown in **Table 3**. Using a capitalization rate of 8.5 percent, this translates into a maximum affordable home value of $166,000. Meanwhile, a four-person household in the moderate-income category can afford to pay rents equivalent to a $191,000 value. Using these assumptions, low-income families can afford between $75,000 and $89,000 depending upon household size, while very low-income households can afford $59,000 for three-person families, and up to $70,000 for four-person families.

## REQUIRED SUBSIDY

**Table 4** compares the production costs of single family and multi-family units outlined earlier with the maximum home values that low- and very low-income families are able to pay. The table also shows the calculation of subsidy required to bridge the difference between these two amounts. The first column of **Table 4** shows estimated home production costs for the four housing prototypes defined above. As shown, the cost of building a two-bedroom single family home is $155,224. The second set of columns shows the maximum home prices that families are able to pay, as calculated in **Table 3**. For example, a low-income family of three can afford a maximum of approximately $122,484 for a two-bedroom single family home. In the third set of columns, the shortfall between the market price and the ability to pay is calculated. Continuing with the previous example, the shortfall for the three-person, low-income family is $32,740.

**Table 5A** and **Table 5B** show the number of units that will be required for each Alternative, categorized by type and size, as described in **Table 1A** and **Table 1B**. As shown, 192 2-bedroom single family units will be required to serve the needs of low-income families in Alternative A. The subsidy required for each income category is calculated by multiplying the shortfall per unit by the number of affordable units that will be required to implement that Alternative. For example, to address the shortfall of all 192 two-bedroom single family units required for low-income households in Alternative A, a $6.3 million subsidy will be required. The total subsidy that will be required to construct all affordable units is also shown. Implementation of Alternative A will require a $117.4 million subsidy, while implementation of Alternative B would require a total subsidy of $202.6 million.

## OFFSETTING AFFORDABLE HOUSING SUBSIDIES

There are a number of sources used by local jurisdictions and the nonprofit housing sector to construct affordable housing units. Most important among these are the Federal and State tax credit programs which are available to both nonprofit and private housing developers willing to limit the rents charged on a given property for a specified amount of time. For example, developers of the Timothy Road affordable housing project have set-aside 30 percent of units to very low-income households, 50 percent of units to low-income households, and 16 percent of units to moderate-income households. The tax credits received for this project average more than $100,000 per unit. For the purpose of this analysis, it has been assumed that tax credits equal to 40 percent of the total subsidy required will be secured.

In addition to tax credits, other local funding sources include RDA set-aside funds, property transfer tax revenues, and additional sources. At this time, it is assumed that these sources will be allocated to other affordable housing programs in the City.

Also, the City is encouraging housing developers to increase construction of qualifying affordable housing units within their projects (thus avoiding the paramount of in-lieu fees). A variety of "affordability by design" techniques are allowed by planning and zoning regulations including second units, small multi-family units integrated into single family neighborhoods, and mixed use projects (e.g., residential flats over commercial uses).

**Table 3**
**Calculation of Ability to Pay for Housing by Income Category**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Item | AFFORDABILITY CALCULATION 3-Person Household | | 4-Person Household | | Notes |
|---|---|---|---|---|---|
| | Monthly Payment | Affordable Home Value | Monthly Payment | Affordable Home Value | |
| **Moderate Income Category** | | | | | |
| Single Family Home | $1,563 | $254,550 | $1,762 | $286,949 | (1) - (6) |
| Multi-Family Home | $1,179 | $166,447 | $1,350 | $190,518 | (1) and (7) - (9) |
| **Low Income Category** | | | | | |
| Single Family Home | $752 | $122,484 | $861 | $140,156 | (1) - (6) |
| Multi-Family Home | $534 | $75,388 | $627 | $88,518 | (1), (7), (8), (10) |
| **Very Low Income Category** | | | | | |
| Single Family Home | $474 | $77,204 | $552 | $89,827 | (1) - (6) |
| Multi-Family Home | $420 | $59,294 | $498 | $70,235 | (1), (7), (8), (11) |

(1) See Table 2 for Income Assumptions.
(2) Mortgage calculated using annual interest rate of 7.25 percent.
(3) Mortgage calculated on 360-month loan.
(4) Mortgage calculated assuming a 10 percent down payment.
(6) Assumes a mortgage-to-income ratio of 0.3 .
(7) Assumes a rent-to-income ratio of 0.3 .
(8) Assumes a capitalization rate of 8.5 percent.
(9) Assumes monthly operating expenses of $350 for Moderate Income category, based on comparable expenses for Bay Area rental units.
(10) Assumes monthly operating expenses of $300 for Low Income category.
(11) Assumes monthly operating expenses of $275 for Very Low Income category.

Source: Economic and Planning Systems, Inc.

**Table 4**
**Calculation of Shortfall per Unit by Housing Type and Income Category**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Unit Type | Production Cost of Home (1) (A) | Ability to Pay (2) Moderate Income | Low Income (B) | Very Low Income | Shortfall Per Unit (3) Mod. Income | Low Income (A) - (B) = (C) | Very Low Income |
|---|---|---|---|---|---|---|---|
| **Single Family** | | | | | | | |
| 3-Persons/2-Bed | $155,000 | $254,550 | $122,484 | $77,204 | $0 | $32,516 | N/A |
| 4-Persons/ 3-Bed | $190,000 | $286,949 | $140,156 | $89,827 | $0 | $49,844 | N/A |
| **Multi-Family** | | | | | | | |
| 3-Persons/ 2-Bed | $139,000 | $166,447 | $75,388 | $59,294 | $0 | $63,612 | $79,706 |
| 4-Persons/ 3-Bed | $179,000 | $190,518 | $88,518 | $70,235 | $0 | $90,482 | $108,765 |

(1) Single-family home values calculation assumes production cost of $141/SF, and 1,100 SF for 2-bedroom homes, 1,350 SF for 3-bedroom homes. Multi-Family units are based on production cost of $163/SF and 850 SF for a 2-BR unit and 1,100 for 3-BR unit.
(2) See **Table 3** for calculation of ability to pay.
(3) Very-Low Income Households are assumed to reside in Multi-Family units, so the subsidy required for Single-Family units is not calculated.

Source: Economic & Planning Systems, Inc.

**Table 5A**
**Calculation of Total Subsidy Required: Alternative A**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Unit Type | Shortfall Per Unit (1) Mod. Income | Low Income | Very Low Income | Units Required (2) Mod. Income | Low Income | V. Low Income | Gross Subsidy by Category Mod. Income | Low Income | Very Low Income | Total Subsidy Required |
|---|---|---|---|---|---|---|---|---|---|---|
| | | (A) - (B) = (C) | | | (D) | | | (C) X (D) = (E) | | |
| **Single Family** | | | | | | | | | | |
| 3-Persons/2-Bed | $0 | $32,741 | N/A | 0 | 192 | 0 | $0 | $6,286,272 | N/A | $6,286,272 |
| 4-Persons/ 3-Bed | $0 | $50,347 | N/A | 0 | 191 | 0 | $0 | $9,616,277 | N/A | $9,616,277 |
| **Multi-Family** | | | | | | | | | | |
| 3-Persons/ 2-Bed | $0 | $63,612 | $79,706 | 0 | 191 | 382 | $0 | $12,149,892 | $30,447,692 | $42,597,584 |
| 4-Persons/ 3-Bed | $0 | $90,482 | $108,765 | 0 | 191 | 383 | $0 | $17,282,062 | $41,624,366 | $58,906,428 |
| | | | | | 765 | 765 | $0 | $45,334,503 | $72,072,058 | $117,406,561 |

(1) See **Table 4** for calculation of subsidy required per unit.
(2) See **Table 1A** for distribution of affordable housing units

Source: Economic & Planning Systems, Inc.

**Table 5B**
**Calculation of Total Subsidy Required: Alternative B**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| | **Shortfall Per Unit** (1) | | | **Units Required** (2) | | | **Gross Subsidy by Category** | | | **Total Subsidy Required** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Unit Type** | Mod. Income | Low Income<br>**(A) - (B) = (C)** | Very Low Income | Mod. Income | Low Income<br>**(D)** | V. Low Income | Mod. Income | Low Income<br>**(C) X (D) = (E)** | Very Low Income | |
| **<u>Single Family</u>** | | | | | | | | | | |
| 3-Persons/2-Bed | $0 | $32,741 | N/A | 0 | 243 | 0 | $0 | $7,956,063 | N/A | $7,956,063 |
| 4-Persons/ 3-Bed | $0 | $50,347 | N/A | 0 | 243 | 0 | $0 | $12,234,321 | N/A | $12,234,321 |
| **Multi-Family** | | | | | | | | | | |
| 3-Persons/ 2-Bed | $0 | $63,612 | $79,706 | 0 | 242 | 770 | $0 | $15,394,104 | $61,333,767 | $76,727,871 |
| 4-Persons/ 3-Bed | $0 | $90,482 | $108,765 | 0 | 242 | 770 | $0 | $21,896,644 | $83,694,668 | $105,591,312 |
| | | | | | 970 | 1,539 | $0 | $57,481,132 | $145,028,435 | $202,509,567 |

(1) See **Table 4** for calculation of subsidy required per unit.
(2) See **Table 1B** for distribution of affordable housing units

Source: Economic & Planning Systems, Inc.

# IV. POLICY RATIONALE AND CALCULATION OF FEE

The previous Chapter documents that there is a need for between $117 and $203 million in total subsidies to address affordable housing needs in the City of Santa Rosa. The Inclusionary Housing In-Lieu Fee is intended to help close the funding gap between the ability to pay of lower-income households and the price of housing. This Chapter outlines the policy rationale for imposing an inclusionary housing policy and in-lieu fee, and then documents the calculations performed to arrive at an in-lieu fee for the City of Santa Rosa.

## NEXUS ANALYSIS

The City of Santa Rosa has Zoning Ordinance Provisions that require all subdivisions over a given size to provide that 20 percent of the units constructed are affordable to low- and very-low income families.

Under State and Federal law, mitigation fees such as the Inclusionary Housing In-Lieu Fee must substantially advance a legitimate State interest in order to constitute a legal exercise of a municipality's police power. In a recent case, *Home Builders Association of Northern California vs. City of Napa*, the City of Napa had enacted an inclusionary housing ordinance much like the ordinance under consideration for Santa Rosa. The Home Builders Association of Northern California (HBA) filed suit alleging the Napa ordinance violated the takings clause of the Federal and State Constitutions and Mitigation Fee Act (California Government Code Sec. 66000 et seq.). Applying the constitutional tests, the court held that the provision of affordable housing was a legitimate State interest and that the affordable housing requirements imposed on new development clearly advanced those interests.

The court reasoned first that the provision of affordable housing is a legitimate State interest, as has been held in previous cases by the California Supreme Court. Second, the court held that the imposition of a requirement to provide affordable housing, or payment of a fee in-lieu of meeting that requirement, clearly advanced the effort to provide affordable housing in Napa by furnishing either actual affordable units or funds to develop such units. Under this standard, the in-lieu fee proposed by the City of Santa Rosa appears to be legal.

Some earlier court cases have required that a "nexus" be established between a condition or burden placed on the land in question and the impacts caused by the proposed use. In Santa Rosa there is a finite amount of developable land within the City limits available for housing of all types, including affordable housing. As this land is developed, the amount of land available for affordable housing is diminished, and with it the opportunity to provide affordable housing. This connection between affordable housing availability and new home development constitutes the "nexus" necessary to justify the affordable housing in-lieu fee. The following section will discuss four options for charging the in-lieu fee, each of which is a method of meeting the nexus requirement by allocating the costs of providing affordable housing across the land in Santa Rosa available for development.

As mentioned in previous chapters, the nexus analysis establishes the maximum fee that a City may charge to mitigate a burden imposed by new development. Individual jurisdictions may, and often do, set fee amounts that are less that the maximum fees identified in the nexus analysis.

## CALCULATION OF FEE

There has been considerable discussion during the past year related to the basis on which the in-lieu fee should be calculated. In the past, the City of Santa Rosa has charged all applicable units the same fee, equal to $2,600 per unit. In light of the nexus analysis discussed in the previous section, it has been suggested that the new in-lieu fee be structured so that residential development consuming greater amounts of land are required to pay a higher in-lieu fee. The following section describes four possible options for implementing the in-lieu fee: a per unit calculation (Option 1); a per lot-square foot calculation (Option 2); a per building-square foot calculation (Option 3); and a fee based on the market value of new residential units (Option 4).

To calculate each of the in-lieu fee structures described above, the total subsidy required for each alternative, net of any other potential funding sources, is divided by the appropriate base (residential units, lot square feet, building square feet, or market value) of new residential development anticipated within the City of Santa Rosa through 2006. Thus, before in-lieu fees can be calculated for each Alternative, the appropriate base must first be determined for each potential fee structure. The base for the per unit fee has been discussed throughout this Report, and is equal to 7,654 new residential units, as shown in **Table 6**.

This base of new residential units were grouped into residential density categories, as defined in the General Plan, with the assistance of the City's Community Development Department based on the number of vacant acres currently available for residential development. This information was used to estimate the number of lot square feet associated with each of the 7,654 new residential units anticipated. As shown in **Table 6**, more than 69 million square feet of land are likely to be developed for residential use over the next five years. Similar estimates are shown for the total number of building square feet, and the total market value of all residential development expected through 2006. These estimates serve as the basis for calculating the in-lieu fee options described below.

**Table 6**
**Expected Units through 2006 and Corresponding In-Lieu Fees**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| **Density Category** | **Vacant** | **Average** | | | | **New** | **Totals** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Acres** (1) | **Density** | **Lot SF** (2) | **Unit SF** (2) | **Price** | **Units** | **Lot SF** | **Unit SF** | **Price** |
| Very Low Density | 1,057 | 1 | 32,700 | 4,000 | $600,000 | 1,056 | 34,538,000 | 4,225,000 | $633,733,000 |
| Low Density | 849 | 5 | 6,500 | 2,000 | $400,000 | 4,267 | 27,737,000 | 8,534,000 | $1,706,878,000 |
| Medium Low Density | 75 | 10 | 3,300 | 1,500 | $325,000 | 741 | 2,444,000 | 1,111,000 | $240,687,000 |
| Medium Density | 110 | 13 | 2,500 | 1,000 | $250,000 | 1,443 | 3,607,000 | 1,443,000 | $360,696,000 |
| Medium High Density | 6 | 24 | 1,400 | 700 | $200,000 | 147 | 206,000 | 103,000 | $29,445,000 |
| **Total/Average** | 2,098 | | | | | 7,654 | 68,532,000 | 15,416,000 | $2,971,439,000 |

(1) The 7,654 new housing units expected through 2006 is equal to approximately 45 percent of total potential units through buildout in the City. This proportion was used to estimate the total residential acres likely to be developed through 2006.
(2) Assumes net acreage for residential development is equal to 75 percent of gross acreage.

Sources: City of Santa Rosa General Plan; Economic & Planning Systems, Inc.

## OPTION 1: FEE CHARGED PER RESIDENTIAL UNIT DEVELOPED

The benefits of charging residential development the same fee for each unit constructed are that the fee is easy to implement and it is supported by the nexus relationship between scarcity of land and ability to provide affordable housing, as described in the previous section. However, if Option 1 is implemented, then homes on smaller lots that consume less of the City's land will pay the same fee as homes built on large one-acre lots of land. Because the smaller lot homes tend to sell for less money than larger lot homes, the fee burden will be considerably higher for the smaller lot homes. Consequently, this may create an incentive for developers to build more lower-density homes, thereby further eroding the amount of land available for affordable housing development in the City.

As indicated in the previous Chapter, implementation of Alternative A would require a total subsidy of $117 million, as shown in **Table 7A**. However, other funding sources exist which can help achieve the City's affordable housing goal, such as low-income housing tax credits. Before calculating the in-lieu fee, these potential revenues, which are expected to contribute approximately 40 percent of the total subsidy required (or $47 million), were subtracted from the total need to arrive at a balance of roughly $70 million in net subsidy requirements. Dividing this subsidy obligation by the 7,654 housing units expected to be subject to the fee through 2006 results in a maximum in-lieu fee of $9,193 per market rate unit that can be supported by the nexus analysis. A similar calculation was performed for Alternative B, which results in a per unit fee of up to $15,875, as shown in **Table 7B**.

## OPTION 2: FEE CHARGED PER SQUARE FOOT OF LAND CONSUMED

The primary benefit of charging residential development in relation to the amount of land they consume is that it achieves the closest nexus between the fee imposed and the City's legitimate policy interest related to affordable housing. By structuring the fee on a per square foot basis, the in-lieu fee charges an amount proportional to the amount of land consumed, and therefore proportional to the consumption of the resources available for affordable housing. While Option 2 is not as easy to administer as the per-unit fee described above, implementing this fee structure would not be unduly complicated.

Calculating the per lot square foot fee is similar to the calculations described above for the per-unit fee. As shown in **Table 6**, the 7,654 new housing units anticipated in the City of Santa Rosa over the next five years are expected to consume 69 million square feet of land, based upon the availability of vacant land by density category and average densities outlined in the City's General Plan. Dividing the net subsidy requirement of

**Table 7A**
**In-Lieu Fee Calculation: Alternative A**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Item | Percent | Fee Base for Calculation (1) | | Subsidy Required |
|---|---|---|---|---|
| **Policy Framework** | | | | |
| Residential Units Expected Through 2006 | | 7,654 | | |
| Residential Land Square Feet Developed Through 2006 | | 68,532,000 | | |
| Affordable Housing Units (Assumed 20 Percent Set-Aside Policy) | | 1,531 | | |
| Affordable Units as Percent of Total Units | 20% | | | |
| Percentage of RHND Met by Inclusionary Housing Policy | 61% | | | |
| **Total Housing Subsidy** | | | | |
| Subsidy Required for Residential Inclusionary Housing (2) | | | | $117,267,288 |
| **Available Funding Sources** | | | | |
| Tax Credits (Assumed to Equal 40% of Total Subsidy Requirement) | | | | $46,906,915 |
| **Net Subsidy Requirement** (3) | | | | **$70,360,373** |
| **Implied In-Lieu Fee** (4) | | | | |
| Fee Per Unit | | 7,654 | (Units) | **$9,193** |
| Fee Per Lot Square Foot | | 68,532,000 | (SF) | **$1.03** |
| Fee Per Building Square Foot | | 15,416,000 | (SF) | **$4.56** |
| Fee Per Dollar of Market Value | | 2,971,439,000 | ($) | **$0.02** |

(1) See **Table 1A** for breakdown of total units by income category. See **Table 6** for assumptions related to lot square feet, building square feet, and market value.
(2) See **Tables 1-5** for calculation of subsidy. The weighted average of subsidies required per units is $76,700.
(3) "Net Subsidy Requirement" is equal to "Total Housing Subsidy" less "Available Funding Sources".
(4) Fee is equal to the total "Net Subsidy Requirement" divided by the fee base.

Source: Economic & Planning Systems, Inc.

**Table 7B**
**In-Lieu Fee Calculation: Alternative B**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| Item | Percent | Fee Base for Calculation (1) | | Subsidy Required |
|---|---|---|---|---|
| **Policy Framework** | | | | |
| Residential Units Expected Through 2006 | | 7,654 | | |
| Residential Land Square Feet Developed Through 2006 | | 68,532,000 | | |
| Affordable Housing Units | | 2,509 | | |
| Affordable Units as Percent of Total Units | 33% | | | |
| Percentage of RHND Met by Inclusionary Housing Policy | 100% | | | |
| **Total Housing Subsidy** | | | | |
| Subsidy Required for Residential Inclusionary Housing (2) | | | | $202,509,324 |
| **Available Funding Sources** | | | | |
| Tax Credits (Assumed to Equal 40% of Total Subsidy) | | | | $81,003,729 |
| **Net Subsidy Requirement** (3) | | | | **$121,505,594** |
| **Implied In-Lieu Fee** (4) | | | | |
| Fee Per Unit | | 7,654 | (Units) | **$15,875** |
| Fee Per Lot Square Foot | | 68,532,000 | (SF) | **$1.77** |
| Fee Per Building Square Foot | | 15,416,000 | (SF) | **$7.88** |
| Fee Per Dollar of Market Value | | 2,971,439,000 | ($) | **$0.04** |

(1) See **Table 1B** for breakdown of total units by income category. See **Table 6** for assumptions related to lot square feet, building square feet, and market value.
(2) See **Tables 1-5** for calculation of subsidy. The weighted average of subsidies required per units is $78,000.
(3) "Net Subsidy Requirement" is equal to "Total Housing Subsidy" less "Available Funding Sources".
(4) Fee is equal to the total "Net Subsidy Requirement" divided by the fee base.

Source: Economic & Planning Systems, Inc.

$70 million associated with Alternative A by the base of 69 million land square feet results in an in-lieu fee of up to $1.03 per lot square foot that is supportable by the nexus. For Alternative B, this calculation yields a fee of up to $1.77 per lot square foot. These calculations are also shown in **Table 7A** and **Table 7B**.

OPTION 3: FEE CHARGED PER SQUARE FOOT OF BUILDING SPACE

Similar to the per lot square foot fee described above, implementing an in-lieu fee based upon the size of individual housing units, or the total building square feet, was also studied. The 7,654 new housing units anticipated in the City of Santa Rosa through 2006 will be comprised of an estimated 15.4 million square feet of total residential building space, as shown in **Table 6**. Using this figure as the basis for fee calculation, implementation of Alternative A would result in a maximum per building square foot fee of $4.56 (**Table 7A**) and Alternative B would warrant a fee of up to $7.88 per building square foot (**Table 7B**).

4. FEE CHARGED IN RELATION TO PRICE OF HOUSING

The final fee structure examined as part of this analysis is an in-lieu fee based upon the price of each residential unit developed. That is, more expensive housing units would pay a higher fee because they are less affordable to very low-, low-, and moderate-income households. Some California municipalities have adopted in-lieu fees on this basis. For example, inclusionary housing in-lieu fees in the Town of Danville are equal to the difference between the residential unit's sales price and the maximum amount affordable to moderate-income households.

Although a reasonable nexus argument can be made for such a policy based upon the City's affordable housing goals, the nexus is not as strong for Option 4 as it is for the land-based fee structures described earlier. In addition, implementation of a price-based fee is considerably more difficult. Instead of collecting in-lieu fees along with other development fees when building permits are pulled, a new system would need to be developed that tracks when units are sold, calculates the appropriate fee, and then charges development accordingly. The nexus analysis supports an ad valorem in-lieu fee of up to $0.02 per dollar of market value for Alternative A and $0.03 per dollar of market value for Alternative B. These calculations are shown in **Table 7A** and **Table 7B**.

## COMPARISON OF FEE STRUCTURES

Because each of the fee structure options described above are calculated using a different basis, it is difficult to compare the potential impacts of implementing each fee without selecting one basis as a standard for comparison. In order to compare the four in-lieu fee options calculated in this analysis, each fee estimate was applied to typical lot and unit sizes, as well as home prices, as shown in **Table 8A** and **Table 8B**. For example, if Alternative A is implemented, the maximum in-lieu fee for developing a low-density unit would be $9,193 under Option 1, $7,454 under Option 2, $9,128 under Option 3, and $9,472 under Option 4. Developing a medium high-density unit on the other hand, would result in the same fee of $9,193 under Option 1, but only $2,485 under Option 2, $3,195 under Option 3, and $4,736 under Option 4. A similar range of fees is shown in **Table 8B**, which illustrates potential fee structures at different density ranges for Alternative B.

**Table 8A**
**Comparison of In-Lieu Fee Methodologies: Alternative A**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| | Assumptions | | | Option 1 $9,193 per Housing Unit | | Option 2 $1.03 per Lot Square Feet | | Option 3 $4.56 per Building Sq. Ft. | | Option 4 $0.02 per Dollar Home Price | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Land Sq. Ft. | Building Sq. Ft. | Sales Price | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden |
| **Residential Density Category** | | | | | | | | | | | |
| Very Low Density | 21,780 | 4,000 | $600,000 | $9,193 | 1.5% | $22,361 | 3.7% | $18,256 | 3.0% | $14,207 | 2.4% |
| Low Density | 7,260 | 2,000 | $400,000 | $9,193 | 2.3% | $7,454 | 1.9% | $9,128 | 2.3% | $9,472 | 2.4% |
| Medium Low Density | 4,840 | 1,500 | $325,000 | $9,193 | 2.8% | $4,969 | 1.5% | $6,846 | 2.1% | $7,696 | 2.4% |
| Medium Density | 3,630 | 1,000 | $250,000 | $9,193 | 3.7% | $3,727 | 1.5% | $4,564 | 1.8% | $5,920 | 2.4% |
| Medium High Density | 2,420 | 700 | $200,000 | $9,193 | 4.6% | $2,485 | 1.2% | $3,195 | 1.6% | $4,736 | 2.4% |

Source: Economic & Planning Systems, Inc.

**Table 8B**
**Comparison of In-Lieu Fee Methodologies:  Alternative B**
**Santa Rosa Inclusionary Housing In-Lieu Fee; EPS #11031**

| | Assumptions | | | Option 1<br>$15,875 per<br>Housing Unit | | Option 2<br>$1.77 per<br>Lot Square Feet | | Option 3<br>$7.88 per<br>Building Sq. Ft. | | Option 4<br>$0.04 per<br>Dollar Home Price | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Land Sq. Ft. | Building Sq. Ft. | Sales Price | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden | Per Unit Fee | Fee Burden |
| **Residential Density Category** | | | | | | | | | | | |
| Very Low Density | 21,780 | 4,000 | $850,000 | $15,875 | 1.9% | $38,615 | 4.5% | $31,527 | 3.7% | $34,757 | 4.1% |
| Low Density | 7,260 | 2,000 | $450,000 | $15,875 | 3.5% | $12,872 | 2.9% | $15,764 | 3.5% | $18,401 | 4.1% |
| Medium Low Density | 4,840 | 1,500 | $375,000 | $15,875 | 4.2% | $8,581 | 2.3% | $11,823 | 3.2% | $15,334 | 4.1% |
| Medium Density | 3,630 | 1,000 | $300,000 | $15,875 | 5.3% | $6,436 | 2.1% | $7,882 | 2.6% | $12,267 | 4.1% |
| Medium High Density | 2,420 | 700 | $250,000 | $15,875 | 6.3% | $4,291 | 1.7% | $5,517 | 2.2% | $10,223 | 4.1% |

Source:  Economic & Planning Systems, Inc.

# V. POLICY CONSIDERATIONS

The analysis documented in this Report provides the basis for updating the City of Santa Rosa's Inclusionary Housing In-Lieu Fee option for residential development. However, the City has the flexibility to implement this fee in a variety of ways. In addition to selecting the unit upon which the fee is based (e.g., per unit or per building square foot), the City can also elect to apply the fee selectively to different types of residential development, particularly if doing so achieves policy goals of the City.

In the past, the City of Santa Rosa has not collected in-lieu fees for medium- and medium high-density units because it was assumed that these units were more likely to be affordable, and the City did not want to unduly encumber them and render them more costly to their targeted households. However, some of the units that were exempted from the fee are now affordable only to moderate- and above moderate-income households. The City will need to consider which types of residential units will be subject to the updated in-lieu fee.

In addition to provisions made for certain density categories, the City may choose to treat other units that are likely to be affordable differently under the in-lieu fee policy. For example, the provision of second units on a single family lot may increase the number of affordable housing units in the community. Consequently, the City could decide to adjust the fee obligations for these types of properties to encourage their development.

As the City moves forward in implementing its inclusionary housing policy and in-lieu fee, a number of policy issues will need to be considered:

- **Qualification.** Under existing policy, only subdivisions smaller than 20 acres qualify for the in-lieu fee option. Larger subdivisions have been required to provide affordable housing units directly. The City Council recently indicated that it will make the in-lieu fee option available only to subdivisions smaller than 15 acres. This decision will likely increase the number of affordable housing units constructed directly by new development, and will decrease in-lieu fee revenues.

- **Application and Exemption.** In the past, the City has exempted qualifying units and other Reserve A units from the in-lieu fee. With adoption of the new in-lieu fee, the City is considering eliminating this exemption, but has expressed support for phasing in the in-lieu fee based on the size of new housing units. Specifically, the Council is considering imposing just 25 percent of the applicable in-lieu fee for homes under 750 square feet in size, 50 percent of the fee for homes between 750 and 949 square feet, 75 percent of the fee for homes between 950 and 1,199 square feet, and charging the full in-lieu fee for homes 1,200 square feet in size or larger. This policy would result in less revenue to the Affordable Housing Fund, but may induce developers to build smaller floor-plate homes. Because smaller homes are often more affordable to low income households, this policy may help accomplish the City's objectives by resulting in a greater supply of affordable housing in the City.

- **Credit.** The City may decide to credit developers with some portion of their in-lieu fee requirements with the construction of units that are "affordable by design." For example, if an above moderate-income housing unit is constructed with a second unit, the City may require the developer to pay only a portion of its in-lieu fee obligation.

# VI. APPENDIX

As described in the Executive Summary, the preliminary findings of this technical report indicated that a maximum in-lieu fee of $4.63 per building square foot could be justified by the nexus analysis, assuming that the full affordable housing need estimated by ABAG's *Regional Housing Needs Determination* were addressed. These findings were derived from a series of initial assumptions related to the cost of providing housing, the amount local families can afford to spend on housing, and the anticipated pace and character of new development in the City of Santa Rosa.

In the process of preparing this Final Report, these assumptions were reviewed and adjusted as necessary to most accurately reflect the City's current understanding of future development in Santa Rosa. Once incorporated into the in-lieu fee analysis, these adjustments produced a significantly higher in-lieu fee amount of $7.88 per building square foot, which can be justified by the nexus relationship between available land and the City's policy of providing affordable housing to its residents. The purpose of this **Appendix** is to document the adjustments made to the preliminary analysis that account for the increased estimate of the maximum in-lieu fee amount.

## PROCESS

Development forecasts for the preliminary study were based on General Plan estimates of the amount of vacant land zoned for residential use within the City limits, as well as industry information related to the typical size of new housing units at different residential densities. These forecasts estimated a total base of approximately 26 million building square feet for new residential units in the City of Santa Rosa through 2006. Following the release of the preliminary in-lieu fee estimates late last year, Staff identified aspects of the development projections that were not aligned with the City's expectations for future development based on their understanding of recent residential projects and other available information.

## AMOUNT AND DISTRIBUTION OF NEW DEVELOPMENT

To account for land that has already been consumed for residential development since the publication of the General Plan, City Staff adjusted the amount of vacant acres zoned for residential use from a total of 4,960 to 4,655 and also redistributed the supply of vacant land among the five residential categories. These changes increased the maximum in-lieu fee by reducing the estimated number of new residential units in the City from 19,815 to 16,985 at buildout. This change reduced the base of total new building square feet anticipated in coming years by approximately 2.4 million square feet. As described in **Chapter 4**, the in-lieu fee was calculated by dividing the total subsidy required to meet the City's affordable housing goals by the aggregate number of building square feet. So, dividing the $122 million in subsidy requirements by a smaller base of building square feet results in a higher in-lieu fee that can be justified by the nexus relationship.

## SIZE OF NEW RESIDENTIAL UNITS

Adjustments were also made to the average number of square feet estimated for new units in each residential density category, based on Staff's knowledge of recent housing development in the City of Santa Rosa. Average unit sizes were adjusted down from 5,000 to 4,000 square feet for very low density, from 3,000 to 2,000 for low density, from 2,400 to 1,500 for medium low density, from 1,600 to 1,000 for medium density, and from 1,100 to 700 for medium high density. When multiplied by each new housing unit anticipated in the City through 2006, these changes reduced the base of total building square feet by another 8.4 million square feet.

In total, the combined effect of these two adjustments to the analysis reduced the base of building square feet from 26.2 million to 15.4 million square feet. Dividing the total subsidy requirement of $122 million by 15.4 million square feet results in a maximum in-lieu fee of $7.88 per building square foot of new market rate housing units, as presented in the Final Report.

It is important to note that the adjustments made to the preliminary analysis reflect an essential step in the process of any fee study. Because the revised fee estimates provided in this Final Report incorporate the most current and comprehensive understanding of development trends in the City, the nexus analysis upon which these fees are based is of greater value to the City, even if the Council moves forward with adoption of the $4.63 in-lieu fee amount. The accuracy of these assumptions will be particularly relevant in future years, when the in-lieu fee estimates are updated to account for General Plan revisions or other significant policy changes that impact the development assumptions or the City's affordable housing goals.