Attachment 1

STUDY SESSION MEMO

CITY OF MOUNTAIN VIEW

DATE: May 14, 2019

TO: Honorable Mayor and City Council

FROM: Wayne Chen, Assistant Community Development Director
Aarti Shrivastava, Assistant City Manager/ Community Development Director

VIA: Daniel H. Rich, City Manager

TITLE: **Below-Market-Rate Housing Program Phase 2 Modifications**

PURPOSE

The purpose of this Study Session is to receive Council feedback on recommendations and considerations for "Phase 2" modifications of the City's Below-Market-Rate (BMR) affordable housing program. Council input will be used to prepare modifications to the BMR Ordinance and guidelines for Council adoption.

BACKGROUND

The City's BMR Affordable Housing Program was originally adopted in 1999 and required both market-rate ownership and rental housing to provide 10 percent of a project's units at specified affordable levels. In 2009, the City paused the rental portion of the BMR Program due to the *Palmer v. City of Los Angeles* case, but continued to implement the ownership portion of the BMR program. In 2012, the City adopted a Rental Housing Impact Fee (RHIF). The passage of AB 1505, also known as the "Palmer Fix," went into effect January 1 2018, which allowed jurisdictions to implement BMR rental housing programs. In response, the City restored the BMR Rental Program and rescinded the RHIF program.

Over the past few years, the City Council has provided input on a variety of housing issues and priorities, including potential modifications to existing rental and ownership housing policies and programs, emphasizing the creation of affordable housing units instead of accepting payment of housing fees, and facilitating housing for the "missing middle." The Council discussed several priorities, concepts, and BMR recommendations in Study Sessions held in September 2017 and November 2017, including:

- Prioritize development of affordable units instead of receiving fees.
- Achieve a diverse income range of affordable housing.
- Increase the affordable housing requirement in the BMR Program from 10 percent to 15 percent for both rental and ownership.
- Increase the Rental In-Lieu Fee.
- Address the need for "missing middle" housing by including the Moderate-Income category (80 percent to 120 percent area median income (AMI) for rental housing, and achieve a range of incomes within the Low-Income and Moderate-Income categories. Also, expand the Moderate-Income range (currently set at 80 percent to 100 percent AMI) for ownership housing and make it 80 percent to 120 percent to be consistent with the standard range for Moderate-Income.
- Evaluation of an "equivalency" framework for low-income and moderate-income units.
- Increase the amount and threshold for ownership in-lieu fees.
- Explore changing the in-lieu fee methodology for ownership housing from 3 percent of closing price to a per-square-foot (psf) amount.
- Provide the ability for developers to request an alternative mitigation without specifying what the alternative mitigation should be.

The City Council supported a two-step, or phased, process to modify the BMR Program and directed the first phase to be implemented immediately. Phase 1 was completed in February 2018 and went into effect April 2018. It included increasing the BMR affordable housing requirement for rental units from 10 percent to 15 percent; updating the BMR Rental In-Lieu Fee with a per-square-foot fee equivalent to the 15 percent requirement, and adding language to the BMR Program to allow developers to request an alternative mitigation (see Attachment 2 for the Council report and Attachment 3 for existing BMR requirements).

After the completion of Phase 1 modifications, staff retained Economic and Planning Systems (EPS) to facilitate the development of Phase 2 modifications based on Council direction. Phase 2 involves an overall update of the BMR Program, including the various modifications identified by the City Council at previous Study Sessions that were not included as part of Phase 1, such as increasing the BMR ownership requirement to 15 percent, incorporating Council's direction regarding the Moderate-Income category, and modifying the in-lieu fee methodology. In addition to the Council-requested BMR modifications, other related program design elements have been incorporated into Phase 2 modifications for EPC and Council consideration for the BMR program to have overall internal consistency.

EPS also conducted a review of program requirements in other jurisdictions that have a BMR program. Most of the jurisdictions with a BMR Rental Program have a 15 percent requirement or more, and have lower income categories than the City's program (see Table 1 below). Similarly, increasing the City's BMR ownership requirement from 10 percent to 15 percent per Council direction would bring the program on par with most of the other jurisdictions with a BMR ownership program, though, again, many of the other jurisdictions set their programs at lower income categories (see Table 2 below).

Table 1. Comparison of BMR Requirements for Rental Developments in Surrounding Jurisdictions

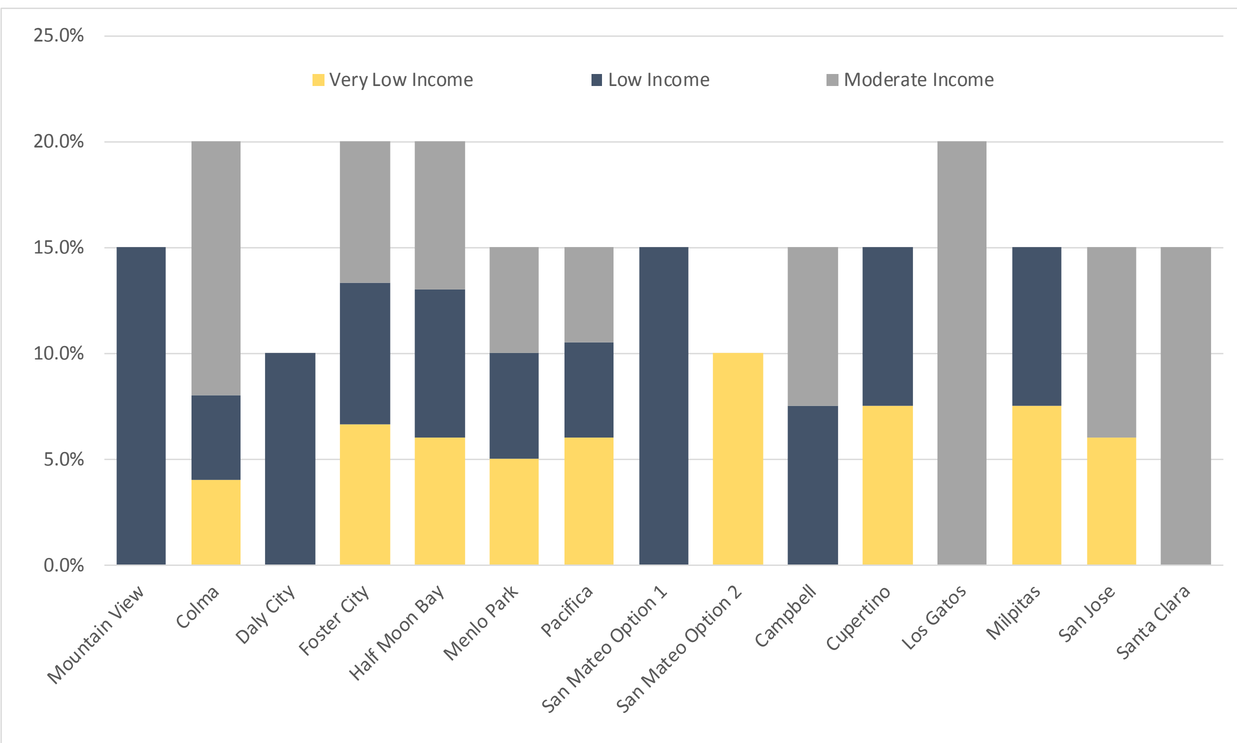
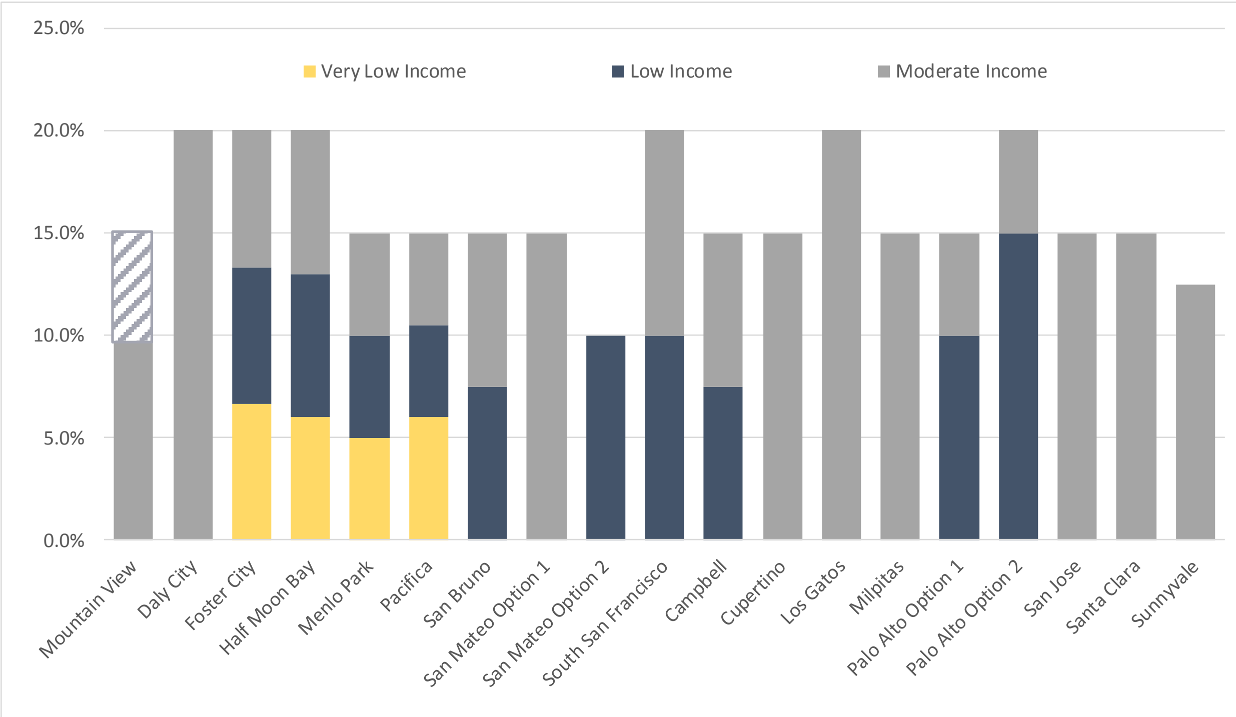


Table 2. Comparison of BMR Requirements for Ownership Developments in Surrounding Jurisdictions



As part of the Phase 2 process, a community meeting was held on March 21, 2019 to receive input (summarized in Attachment 3) on the BMR Program and to inform development of the modifications prior to the release of the draft Guidelines (Attachment 1). On April 29, 2019, the Environmental Planning Commission (EPC) held a Study Session to provide input and recommendations on the draft Guidelines for Council consideration. Two members of the public spoke, one in support of staff's recommendations and the other requesting that projects already in the pipeline be exempt from Phase 2 modifications. Summaries of EPC input are provided below in the relevant sections.

DISCUSSION

This section of the report provides a discussion on key program design principles, considerations, and components for Phase 2 BMR modifications. The draft Phase 2 Guidelines are based on the existing Guidelines; however, various sections have been moved, combined, modified, or added for better organization, flow, and clarity. As such, the draft Phase 2 Guidelines are included in Attachment 1 as a "clean" copy for greater readability but with brief notes describing how each section relates to the existing Guidelines (provided in Attachment 3 as a reference).

Program Design Principles

The Council has provided clear direction on the key policy goals it seeks to achieve—including prioritizing delivery of affordable units instead of receiving fees—and the parameters by which to achieve them through modification of the BMR program. In developing Phase 2 modifications, staff has sought to incorporate Council goals through the following principles:

- Implement Council direction from the Study Sessions.
- Facilitate delivery of affordable housing units.
- Allow for flexibility.
- Incorporate equivalency concepts into the program design.

Definitions

The draft BMR Phase 2 Guidelines include definitions of key terms for the program, with select terms summarized here:

- "BMR unit" and "affordable unit" are used interchangeably in the Guidelines to describe a residential unit with an affordability deed restriction subject to the provisions of the BMR program.
- "For-sale" and "ownership" are used interchangeably in the Guidelines to describe a residential development whose units are meant to be sold and subsequently owned by individual households.
- "Income category" means Moderate-Income, Low-Income, and Very Low-Income household as defined in this section.
- "Income level" means the income at a specified percentage of AMI, such as 65 percent AMI, 110 percent AMI, etc. Each income category is composed of various income levels. For example, 85 percent of AMI, 90 percent of AMI, 110 percent of AMI, etc., each represent various income levels within the Moderate-Income household category.
- "On-site" means that the affordable housing units as required by the BMR program are integrated with the project's market-rate units and dispersed

throughout the development according to the BMR program requirements. Except when required to develop senior housing in compliance with applicable laws, development of the affordable units in a separate, stand-alone structure, even if that stand-alone structure were on the same parcel or APN as a separate market rate building, does not meet the definition of on-site.

- "Low-Income" means the level of gross income for Santa Clara County as published periodically by the State Department of Housing and Community Development, generally defined as between 50 percent and 80 percent of the AMI, adjusted for household size.

- "Moderate-Income" means the level of gross income for Santa Clara County as published periodically by the State Department of Housing and Community Development, generally defined as between 80 percent and 120 percent of the AMI, adjusted for household size.

- "Residential development" means any development that includes an application to the City for planning or building permits to create one or more dwelling units, to convert nonresidential uses to residential uses, or to convert residential units from rental to for-sale. As used in these Guidelines, "residential development" includes, without limitation, rental housing; for-sale housing; mixed-tenure housing; mixed-use residential; detached single-family dwellings; duplexes; triplexes; multiple-family dwelling structures; condominium or townhouse developments; condominium conversions; and land subdivisions intended to be sold or rented to the general public. However, accessory dwelling units and licensed care facilities are excluded from the definition of residential development.

BMR On-Site Requirements

Objective Standard

The basic requirement of the BMR program is the provision of affordable rental and ownership units on-site in connection with the development of market-rate housing. The Guidelines include objective standards with which residential developments must comply, along with alternative mechanisms for meeting the BMR requirements that may be approved by the City Council under a discretionary review process based on standards defined in the Guidelines.

Percentage Requirement and Income Categories

Per Council direction, the BMR Rental Program was increased to 15 percent for the Low-Income category in Phase 1, and Phase 2 adds the Moderate-Income category to the rental program to allow developers to provide some BMR units at rents affordable to households between 80 percent and 120 percent of AMI. The increase for the BMR ownership program from 10 percent to 15 percent is also part of Phase 2, and includes expanding the Moderate-Income range to 80 percent to 120 percent.

As part of the Phase 2 analysis, EPS tested different residential product types that represent most of the current residential pipeline, as well as the expected/desired housing products being planned for, such as those identified in the City's Precise Plans and more urban rental and ownership developments, including stacked flats. Rowhouse and townhouse developments were among of the residential types tested, and the analysis shows that such developments could support a higher BMR requirement—up to 25 percent—given their high sales price and the economics of developing such products. Staff seeks input from Council if it supports a 25 percent requirement for rowhouse/townhouse products as part of Phase 2 modifications.

Question No. 1: Does Council support a higher BMR requirement for rowhouse/townhouse projects, up to 25 percent?

Applicability

The provisions of the City's BMR program shall apply to any residential development that adds dwelling units, converts nonresidential uses to residential uses, or converts rental housing to for-sale housing, including, but not limited to, rental housing, for-sale housing, mixed-tenure housing, and mixed-use residential. However, accessory dwelling units and licensed care facilities are excluded from the definition of residential development.

Residential developments with seven or more units, including ownership, rental, mixed-use, and mixed-tenure developments, shall be required to provide the 15 percent BMR units on-site, except that rowhouses/townhouses could be subject to a higher BMR on-site requirement (pending Council input on Question 1). Residential projects with less than seven units shall have the option of paying a fee in lieu of the fractional affordable housing unit. A developer of a residential project with seven or more units seeking to pay in-lieu fees instead of providing units shall be subject to the alternative mitigation requirements as discussed later in this report.

Weighted Average Methodology

As discussed, the Council seeks to address housing for the "missing middle" by including and expanding the Moderate-Income category for the BMR program, as well as achieving a diverse range of income levels to meet various affordable housing needs. The Council also directed staff to evaluate how the concept of "equivalency" could be incorporated into the BMR program, in part because some developers over the past couple of years have asked if they could meet their BMR rental requirement by providing more Moderate-Income units instead of Low-Income units. However, these requests have implied that only Moderate-Income units would be provided with no provision of Low-Income units or a range of income levels.

Staff's approach to an equivalency framework seeks to incorporate the Council's dual goals of facilitating missing middle housing as well as diverse range of affordable housing at various income levels through the weighted average methodology. This methodology allows developers of both rental and ownership housing to meet their BMR requirements by including affordable housing at a range of income levels, including Moderate-Income housing, provided that the overall income level for all affordable units cumulatively be no greater than a certain AMI level. Specifically:

- It is recommended that market-rate **rental** projects shall provide affordable units on-site at income levels between 50 percent and 120 percent AMI, provided that all of the affordable units be at a weighted average of <u>no greater than 65 percent AMI</u>. The rental project must include a minimum of two income levels to facilitate a more diverse range of affordable housing (e.g., 50 percent and 80 percent AMI; 55 percent and 75 percent AMI; 55 percent, 60 percent, and 100 percent AMI; etc.). The weighted average requirement for the BMR Rental Program is as follows:

  $$\frac{\textbf{(AMI X)(\# of Units @ AMI X)}}{\textbf{Total Aff. Units}} + \frac{\textbf{(AMI Y)(\# of Units @ AMI Y)}}{\textbf{Total Aff. Units}} + \textbf{Etc.} \leq \begin{array}{c}\textbf{65\% AMI}\\ \textbf{Weighted Avg.}\end{array}$$

  The project may include affordable units at less than 50 percent AMI as long as the project meets the weighted average requirement.

- It is recommended that market-rate **for-sale** projects shall provide affordable units on-site at income levels between 80 percent and 120 percent AMI, provided that all of the affordable units be at a weighted average <u>equal to 100 percent AMI</u>. The for-sale project must include a minimum of two income levels to facilitate a more diverse range of affordable housing (e.g., 80 percent and 120 percent AMI; 90 percent and 110 percent AMI; 55 percent, 80 percent, 100 percent, and 120 percent

AMI; etc.). The weighted average requirement for the BMR Ownership Program is as follows:

$$\frac{\textbf{(AMI X)(\# of Units @ AMI X)}}{\textbf{Total Aff. Units}} + \frac{\textbf{(AMI Y)(\# of Units @ AMI Y)}}{\textbf{Total Aff. Units}} + \textbf{Etc.} = \textbf{100\% AMI Weighted Avg.}$$

It is recommended that an 80 percent AMI floor be established for ownership projects. The costs of home ownership often involve both costs that are predictable over the long term (e.g., mortgage payments, taxes, and insurance) and other costs that may increase substantially over time (e.g., homeowners association (HOA) dues and maintenance expenses). Home ownership for households with lower AMI levels can be very difficult to sustain due to future HOA increases or special assessments that can substantially increase the cost of home ownership. However, an applicant could include ownership units at less than 80 percent AMI if the developer sets aside a reserve for future increases in HOA fees and special assessments such that the affordability of the BMR units is preserved for those lower-income households for the life of the BMR units.

The weighted average methodology provides the flexibility for developers to meet their BMR requirements by choosing the income levels of the affordable units. However, the determination of income levels shall meaningfully incorporate City input on desired income levels depending on the housing goals and priorities at the time, as well as progress toward the City's regional housing needs allocation (RHNA). Affordable units shall be proportionately distributed among and representative of the various unit types within the overall development.

Term

The current BMR program includes a requirement for deed restrictions for 55 years for both BMR rental and ownership units. However, BMR programs are allowed to require deed restrictions for longer durations, including an in-perpetuity requirement. Given recent concerns about tenant displacement, the Council's stated goal of the preservation of BMR ownership units, and the overall goal to increase the supply and affordability of housing in Mountain View, staff recommends deed restrictions in perpetuity (in Question 2).

Density Bonus

The current BMR program states that compliance with the program does not entitle a residential development to a density bonus. However, the 2013 Court of Appeals decision *Latinos Unidos del Valle de Napa y Solano v. County of Napa* held that affordable housing provided to satisfy a jurisdiction's BMR requirements must also be counted to qualify for a density bonus, provided that the affordable units meet the requirements of both programs. For Phase 2, the BMR program shall be modified to state that, if a project seeks a density bonus:

- The affordable units provided to meet the City's BMR requirement shall also be counted to qualify for the density bonus, provided that the affordable units meet the stricter of the BMR or density bonus requirements.

- Developers seeking the maximum 35 percent density bonus are required to include 11 percent of the units (as calculated under the "base density," i.e., the number of units that could be built on a site prior to applying the density bonus) at the 50 percent AMI level or 20 percent of the units at the 80 percent AMI level (but with rents set at only 30 percent of the 60 percent AMI level). It is more common for market-rate developers to apply for the maximum density bonus by providing very low-income units. Thus, a 35 percent density bonus would be allowed in rental projects, assuming other requirements are met, because the BMR rental program allows for affordable units between 50 percent and 120 percent AMI.

- Alternatively, an ownership project complying with the Phase 2 recommendations could qualify for a 10 percent density bonus by providing 15 percent of units at 100 percent AMI weighted average. A project with units below 80 percent AMI could request a higher-density bonus provided that those units include a reserve set aside for HOA increases and special assessments that maintain the overall affordability of the unit.

- The BMR requirement shall be calculated based on the number of units that could be built on a site prior to applying the density bonus, i.e., under on the "base density." Note that calculating the BMR requirement using the base density instead of the project's total number of units (including density bonus units) means a lower number of BMR units required for a project. This methodology is meant to align with the generally used interpretation of how to determine a project's BMR obligation. However, there is no case law on this issue.

Summary of BMR Rental and For-Sale On-Site Requirements

Table 3 below compares the existing BMR on-site requirements and recommended Phase 2 modifications for rental projects, and Table 4 is for ownership projects, with a rationale for each component.

Table 3: Comparison of Existing and Recommended Phase 2 On-Site Requirements for BMR Rental Projects

Component	Existing Requirements	Recommended Phase 2 Modifications	Rationale
Objective Standard	– N/A.	– BMR units on-site (i.e., integrated with market-rate units).	– Council priority for BMR units on-site.
Requirement	– 15 percent on-site.	– 15 percent on-site.	– Council direction.
Applicability	– Rental projects with 5 or more units. – Mixed-tenure projects with 6 or more units – Projects can pay in-lieu fee on fractional unit.	– 7 or more units for all residential projects. – Projects less than 7 units can pay in-lieu fee on fractional unit less than 0.5. A unit must be provided for a fractional unit equal to 0.5 or more.	– Simplifies program by using same applicability for all residential projects.
Income Categories	– Low (50 percent to 80 percent AMI).	– Low (50 percent to 80 percent AMI). – Moderate (80 percent to 120 percent AMI).	– Council direction.
Income Levels	– 50 percent to 80 percent AMI. – Typically set at 65 percent AMI.	– 65 percent AMI weighted average . – Requires minimum of two income levels.	– Flexibility. – Range of units. – Equivalency.
Income Floor	– N/A.	– 50 percent AMI but can go lower provided weighted average is met.	– Persistent need for deeper affordability levels for rental.
Term	– 55 years.	– Perpetuity.	– Preserves affordability. – Prevents displacement from expiring deed restrictions.
Density Bonus	– Compliance with BMR requirement does not entitle project to density bonus.	– Affordable housing to satisfy BMR requirements must also be counted to qualify for a density bonus.	– Consistency with court ruling applying State Density Bonus Law.

Table 4: Comparison of Existing and Recommended Phase 2 On-Site Requirements for BMR Ownership Projects

Component	Existing Requirements	Recommended Phase 2 Modifications	Rationale
Objective Standard	– N/A.	– BMR units on-site (i.e., integrated with market-rate units).	– Council priority for BMR units on-site.
Requirement	– 10 percent on-site.	– 15 percent on-site – 25 percent on-site requirement for rowhouse/townhouse projects (pending Council input).	– Council direction – High sales prices of rowhouse/townhouse projects generate significant affordable housing needs and can support higher requirement.
Applicability	– For-sale projects with 3 or more units. – Mixed-tenure projects with 6 or more units. – Projects can pay in-lieu fee on fractional unit or above certain price threshold.	– 7 or more units for all residential projects – Projects less than 7 units can pay in-lieu fee on fractional unit. A unit must be provided for a fractional unit equal to 0.5 or more.	– Simplifies program by using same applicability for all residential projects.
Income Categories	– Moderate (80 percent to <u>100</u> percent AMI).	– Moderate (80 percent to <u>120</u> percent AMI).	– Council direction.
Income Levels	– 80 percent to 100 percent AMI. – Typically set at 90 percent AMI.	– 100 percent AMI weighted average. – Requires minimum of two income levels.	– Flexibility. – Range of Units. – Equivalency.
Income Floor	– N/A.	– 80 percent AMI but can go lower provided weighted average is met and HOA/assessment reserve is established.	– Sustainability of homeownership.
Term	– 55 years.	– Perpetuity.	– Preserves affordability. – Mitigates displacement from expiring deed restrictions.
Density Bonus	– Compliance with BMR requirement does not entitle project to density bonus.	– Affordable housing to satisfy BMR requirements must also be counted to qualify for a density bonus.	– Consistency with court ruling applying State Density Bonus Law.

Question No. 2: Does Council support the recommended BMR on-site requirements for rental and for-sale projects, including BMR units in perpetuity?

Input from April 29, 2019 EPC Study Session:

The EPC supported the recommended BMR on-site requirements for rental and for-sale projects with a 6-1 straw vote. The one no-vote was due to some concern about a 25 percent on-site requirement being too high for rowhouse/townhouse projects.

Alternative Mitigations

An applicant can request an alternative mitigation to providing 15 percent affordable housing on-site (or 25 percent for rowhouse/townhouse developments pending Council input). The request may only be granted if the City Council determines that such alternative will further affordable housing opportunities in the City to a greater extent than providing units on-site based on criteria defined in the Guidelines. As part of the request, the applicant shall demonstrate *at least* the following (however, meeting the below requirements does not constitute automatic approval of the alternative mitigation request):

- The alternative mitigation exceeds the value of the BMR on-site requirements by including deeper affordability, a greater number of BMR units, or both.

- The alternative mitigation advances other City goals for housing and that are of greater priority than the BMR on-site requirements. The Community Development Director or designee will issue written guidance defining the City's housing goals, which may include direction regarding the specific income levels or residential product types desired by the City, including, but not limited to, housing needs based on income level and progress toward meeting the City's regional housing needs allocation (RHNA). Applicants will be required to follow any guidance in determining the appropriate income levels.

Furthermore, the applicant shall demonstrate compliance with <u>additional requirements</u> if one or more of the following alternative mitigations is requested:

- Dedication of land—The value of the parcel dedicated to the City shall be greater than the value of providing the affordable housing units on-site. The minimum parcel size for a dedicated site shall be 0.75 acre of developable area and shall be reasonably able to accommodate more than the number of affordable units as would have been provided on-site. Developable area is defined as the site area exclusive of streets, sidewalks, and street or other public rights-of-way. The site shall have a sufficient width and depth to permit development of a greater number of BMR units that comply with applicable development standards that would be required if the units were provided on-site. The dedicated site must be suitable for affordable housing development in terms of its configuration, physical and environmental characteristics, access, location, adjacent uses, and other relevant planning criteria.

- Development of affordable housing units off-site—An applicant may meet its BMR requirement by developing the affordable housing units off-site. "Off-site" may mean another location within the market-rate project's parcel or on a separate parcel elsewhere. The off-site units shall be at least 20 percent of the total number of residential units for the project, defined as the combined total of the market-rate residential units and the off-site affordable housing units. The off-site affordable development shall be suitable in terms of location and project type, and shall be delivered to the City prior to issuance of Certificate of Occupancy for the market-rate units.

- Provision of in-lieu fees—The in-lieu fee amount shall be sufficiently greater than the value of developing the affordable housing units on-site; be paid by the applicant prior to issuance of the first building permit; and be higher than the psf levels stipulated below. The applicant shall demonstrate why it is in the City's interest to receive fees instead of on-site units, and considerations may include, but are not limited to, the value of an early payment of the in-lieu fee, need for housing fees to facilitate the City's affordable housing development pipeline, and/or other factors. If the project has multiple phases, the full amount of the in-lieu fee for the whole project shall be paid prior to issuance of the first building permit for the first phase. Determination of the in-lieu fee amount is discussed below regarding the basis of the fee.

Note that under the current BMR program, for-sale units priced above a certain threshold (approximately $750,000 currently and adjusted annually) are allowed to pay a fee in lieu of providing units. Given the extraordinarily high cost of housing in Mountain View, essentially all for-sale units have been priced well above that threshold and have opted to pay in-lieu fees instead of producing BMR ownership units. Because the high cost of for-sale housing is what makes homeownership unattainable for most households, allowing for-sale projects to fee out because the sales price is too high creates an inherent contradiction. Given the goal for more affordable homeownership opportunities, it is recommended that all ownership projects with seven or more units be subject to the 15 percent on-site requirement (or recommended 25 percent for rowhouse/townhouse developments pending Council input) regardless of the sales price, and that a request to pay fees in lieu of providing units would be considered an alternative mitigation. Note that it is recommended that BMR for-sale units (as well as BMR rental units) have deed restrictions in perpetuity to preserve affordability levels, which means that no household would receive windfall profits upon resale, unlike BMR programs that may exist in other jurisdictions.

Question No. 3: Does Council support the recommendations regarding alternative mitigations?

Input from April 29, 2019 EPC Study Session:

The EPC supported the recommendations regarding alternative mitigations with a 7-0 straw vote. Two Commissioners commented that alternative mitigations that result in BMR units off-site should not lead to a concentration of BMR units in certain locations.

In-Lieu Fees

The BMR Phase 2 modification process included an analysis of fees in lieu of units for both rental and ownership housing. The analysis included consideration of Council's priority for developers to deliver affordable housing units instead of paying in-lieu fees, as well as the concept of equivalency. Based on current development costs, rent levels, sales prices, and other factors, the analysis indicates that a fee of $96 per net habitable square foot for rental projects and $54.50 per net habitable square foot for ownership projects are equivalent to the 15 percent on-site BMR requirement. In other words, at these fee levels, developers should theoretically be economically indifferent to providing the units on-site or paying a fee in lieu of units. If Council supports a higher BMR requirement for rowhouse/townhouse products, an equivalent fee level would be determined.

The fee study included a comparison with other jurisdictions with BMR programs. In-lieu fees range from $6.67 to $36.40 per net habitable square foot for rentals and $6.67 to $75 per net habitable square foot for ownership units. Note that fees in other jurisdictions were set based on various factors and at different times in the market cycle, and are usually at levels significantly below the developer's equivalency of providing the units on-site or the amount required to build an affordable unit off-site. BMR programs generally adjust fee levels annually based on the Consumer Price Index (CPI).

It is recommended that:

- A project be allowed to pay fees in lieu of units when the BMR obligation results in a fractional unit that is less than 0.5 (i.e., less than half a unit) based on the fee level that will ultimately be determined by the City Council. A fractional unit equal to

0.5 or greater shall be rounded up and provided as a whole BMR unit on-site. The payment shall be made in full prior to issuance of the project's first building permit.

- Provision of fees in lieu of whole units shall be considered an alternative mitigation and subject to those requirements, including providing a greater value than the on-site requirement.

- The rental and ownership fees shall be adjusted annually by the Consumer Price Index, All Urban Consumers, San Francisco-Oakland-San Jose, published by the U.S. Department of Labor, Bureau of Labor Statistics. The fee will be set by resolution and will be adjusted annually as part of the City's budget process.

Question No. 4: Does Council seek to facilitate the delivery of BMR units on-site by setting the fee level equivalent to the value of on-site units (calculated at $96 per net habitable square foot for rental projects and $54.50 per net habitable square foot for for-sale projects)?

Input from April 29, 2019 EPC Study Session:

The EPC supported a rental in-lieu fee of $96 per net habitable square foot for rental developments and $54.50 per net habitable square foot for ownership developments with a 6-1 straw vote. The one no-vote was based on support for the ownership fee but concern about the rental in-lieu fee being too high. Overall, the EPC supported the objective standard of requiring BMR units on-site; the concept that a fee level equivalent to the on-site requirement facilitates meeting the objective standard; and that in-lieu fees are an alternative mitigation and should be considered an exception (other than for fractional units).

Timing of Delivery

The timing of the delivery of a project's BMR requirements depends on how those requirements are being met, the number of phases in a project, and if it is a mixed-use project.

Projects incorporating BMR units on-site shall deliver those units concurrently with the market-rate units. In phased developments, the total BMR requirement shall be calculated on the basis of the whole development, each phase shall include the required number of BMR units based on the number of market-rate units in each phase, and on-site units shall be developed concurrently with the market-rate units in each phase.

If an applicant requests an alternative mitigation, satisfaction of the affordable housing obligations shall occur as follows:

- Land dedication: The parcel shall be deeded to the City prior to issuance of the project's first building permit.

- Build off-site: Entitlement and construction of the off-site affordable housing project shall be delivered no later than the market-rate project.

- In-lieu fees: Fees in lieu of providing on-site affordable units shall be paid in full prior to issuance of the first building permit. If an applicant wishes to pay the fee early and early payment would be of value to the City, the timing of the early payment shall be determined between the applicant and the City.

- If an applicant requests an alternative mitigation in a phased project, delivery of the affordable housing obligation shall occur prior to issuance of the first building permit for the entire project. For a residential mixed-use project with one or more phases, delivery of the affordable housing obligation shall occur prior to the issuance of the project's first building permit, including if the first building permit is for a nonresidential use. If the applicant seeks the off-site options in a phased development, the total BMR requirement shall be calculated on the basis of the whole development, and Certificate of Occupancy for the market rate units in the first phase shall not be issued until issuance of the Certificate of Occupancy for the BMR units.

Exemptions

Phase 1 modifications went into effect 60 days after the second reading by Council, and the following projects were exempted from Phase 1 modifications:

- Gatekeeper projects with project entitlement by effective date of BMR Phase 1 modifications.

- Non-Gatekeeper projects with formal applications submitted and determined complete by effective date.

It is anticipated that the Council will hold first and second readings of BMR Phase 2 modifications on June 18 and June 25, 2019. If Council wishes to have the same 60-day effective period, then Phase 2 modifications would go into effect August 24, 2019.

The City currently has 19 residential projects comprising 3,057 net new units in the pipeline composed of "regular" Gatekeeper projects, transfer of development rights (TDR) Gatekeepers, and non-Gatekeeper projects. The majority of the residential pipeline are Gatekeeper projects, comprising nine projects and 2,692 units. If the effective date of Phase 2 modifications is August 24, 2019 and the same exemption as in Phase 1 modifications is used, it is estimated that three Gatekeepers totaling 1,186 units would be exempt from Phase 2 modifications, and four projects totaling 1,506 units would be subject to the new requirements (see Table 5 below).

Table 5: Gatekeeper Residential Pipeline

	Entitlement Expected Before August 24, 2019 and Exempt from Phase 2		Entitlement Expected After August 24, 2019 and Subject to Phase 2		Total Units
	Projects	Net New Units	Projects	Net New Units	
"Regular" Gatekeepers	3	1,186	4	681	**1,867**
"TDR" Gatekeepers	0	0	2	825	**825**
TOTAL	**3**	**1,186**	**6**	**1,506**	**2,692**

The remaining 10 market-rate projects in the current pipeline are non-Gatekeeper projects that have submitted formal applications comprising 365 units. There may be new non-Gatekeeper projects that attempt to "rush in" to file a formal application prior to the Phase 2 effective date, and that could lead to applications that are incomplete and/or have inadequate responses to required information. Therefore, it is recommended that for non-Gatekeeper projects there be consideration for an application submittal date prior to the Phase 2 effective date as part of the exemption provision that would allow sufficient time for staff to provide: (1) a 30-day comment letter to the applicant; and (2) for the applicant to respond to request for additional information in the 30-day letter by the effective date of Phase 2 modifications.

If an exemption period is desired and Council seeks an exemption provision similar to Phase 1 (i.e., a 60-day effective period and a distinction between Gatekeeper and non-Gatekeeper projects), Council could consider the following exemptions for Phase 2 modifications:

- Gatekeeper projects with project entitlement by effective date of BMR Phase 2 modifications.

- Non-Gatekeeper projects with formal applications submitted by June 30, 2019, provided that, prior to the effective date of Phase 2 modifications, applicants must have submitted all of the additional information as requested in the City's 30-day letter responding to the applicant's formal application submittal.

The Council could provide other direction on Phase 2 exemptions.

Question No. 5: Does Council agree with the exemption provision for Phase 2 modifications noted above?

Input from April 29, 2019 EPC Study Session—The EPC did not take a straw vote about the exemption provision and instead provided various input for consideration. Three Commissioners supported the suggested exemption provision above, with two of the Commissioners stating that, while projects should generally have the reasonable expectation that they are subject to requirements in place at the time of project submittal, Gatekeepers should have the expectation that policies or requirements could change during their entitlement process. Two Commissioners suggested a longer period after the second reading, such as 90 days instead of 60 days, for the modifications to go into effect.

Rental Projects with Condominium Maps

In the past, Council has expressed an interest in rental projects that have condominium subdivision maps because that would allow greater flexibility for such projects to later convert to ownership housing. Assessing the barriers to, and exploring opportunities to facilitate, such condo-mapped rental projects is a work plan item under the Fiscal Year 2017-19 Council Major Goals. Under the current BMR program, condo-mapped rental projects have been treated as an ownership project and subject to the 3 percent in-lieu fee, which, based on developer input, made it cost-prohibitive to condo-map a rental project.

Because the priority of the BMR Phase 2 program is the delivery of affordable units on-site, a condo-mapped rental project would provide BMR rental units on-site. If and when the project converts to ownership units, the BMR rental units would also need to convert to BMR ownership units based on the Guidelines.

As mentioned above, the analysis shows that a rental fee equivalent to the 15 percent obligation is $96 per net habitable square foot for rental projects and $54.50 per net habitable square foot for ownership projects. The actual fee levels to be established for Phase 2 modifications will be based on Council direction. If an applicant requests payment of fees in lieu of units as an alternative mitigation and it is approved by Council, it is recommended that the in-lieu amount be based on the rental fee level that will be established by Council (assuming that the rental in-lieu fee is higher than the ownership in-lieu fee). If the rental fee level is not used as the basis for in-lieu fees for condo-mapped rentals and instead is charged a lower rate, developers could have an incentive to build condo-mapped rentals but request to pay an in-lieu fee instead of building BMR units on-site. To the extent that is true, consideration of a fee level for condo-mapped rental projects depends primarily on the policy priority: is it to receive condo-mapped rentals that seek to pay in-lieu fees, or is it to have rental projects (without a condo-map) with BMR units on-site? However, note again that payment of an-lieu fee shall be a request under the provisions of the BMR program's alternative mitigation requirements, and Council has discretion to approve or deny the request.

Other Elements/Requirements

BMR Phase 2 modifications include various general requirements and administrative elements, including:

- Dispersal of BMR units throughout the building, built to comparable quality and standards as market-rate units with the exception of luxury amenities, and in fixed locations.

- Rents and sales prices based on an assumed household size equal to the number of bedrooms in the unit, plus one. For example, a 1-bedroom unit would have rents/sales price based on a household of two; a 2-bedroom unit would have rents/sales price based on a household of three, etc.

- The minimum occupancy standard is one person per bedroom, with exceptions for reasonable accommodation needs.

- Various compliance requirements regarding lease agreement terms, primary place of residence, restrictions on subletting, and resale provisions for BMR ownership units.

Annual Eligibility

Staff seeks Council input on the approach toward the annual verification of tenant eligibility. As mentioned, housing costs and household sizes for any particular BMR unit shall be based on the bedrooms plus one formula. In 100 percent affordable rental projects that include City subsidy, tax credits, and/or other public funding sources, a qualifying household that later exceeds the income limit of the affordable unit would transition out of the unit or the unit could be modified to allow a higher income. The options and/or requirements for addressing upward changes in income or downward changes in household size in 100 percent affordable housing projects depend on the requirements attached to public funding sources (such as tax credits, Federal funding sources, or other sources).

Because BMR projects typically do not include public funding sources, there is flexibility in how to address over-income households based on policy goals. If the goal is to preserve the stability of the existing household, then the BMR program would have more flexible ongoing requirements to allow over-income households to stay in their unit. If the goal is to allow eligible households on the waiting list to be placed into an affordable unit, then the BMR program would have stricter ongoing requirements that would transition over-income households out of the affordable unit (but they may be unable to afford local market rents).

The BMR program could seek to balance the goal of preserving the existing tenancy and the goal of placing eligible households on the waiting list into an affordable unit through a two-tiered approach: a household may exceed the AMI level of the BMR rental unit by a certain number of percentage points and still remain in the unit (first tier), and if the household exceeds that threshold, the household has up to a certain period of time to transition out of the BMR unit (second tier). For example, a household making 65 percent of AMI qualifies for a BMR unit with rents set at the 65 percent AMI affordability level. The BMR program could be designed to allow the household to earn up to 75 percent of AMI (i.e., be over-income by 10 percentage points) and still remain in the unit (first tier). If the household later earns more than 75 percent of AMI, then the household would have one year to transition out of the unit (second tier). Depending on the flexibility desired, this two-tiered approach could be modified by adjusting the amount a household can be over-income and still stay in the unit and/or the length of the transition period allowed for a household that exceeds the "over-income threshold" to move out of the unit. The affordable housing guidelines for the North Bayshore Precise Plan include a similar two-tiered approach.

Question No. 6: Does Council support the two-tiered approach outlined above for ongoing tenant eligibility?

Input from April 29, 2019 EPC Study Session:

The EPC did not take a straw vote on this question but overall supported the two-tier strategy for annual eligibility for renters as a reasonable way to balance preserving the stability of existing renters while allowing eligible households on the waiting list to be placed into a BMR unit. One Commissioner suggested including the provision that a one-time, temporary increase in income not be factored into the annual eligibility determination. Another Commissioner suggested exploring additional flexibility for BMR units to "swap" AMI levels with each other if needed to better match the rent levels of the units with the incomes of the tenants if certain tenants become over-income. (Staff notes that the flexibility to swap the AMI levels among BMR units could increase flexibility, but it could be more complex and costly to administer and monitor compliance over time).

Ordinance Modifications

The BMR Ordinance shall be modified to align with Phase 2 modifications, including the definition of Moderate-Income, the BMR on-site requirement for ownership projects, applicability, and the treatment of fractional units. Draft Ordinance modifications will be included as part of the public hearings per the schedule below.

Question No. 7: Does Council have input on other components of Phase 2 modifications?

Input from April 29, 2019 EPC Study Session:

The EPC provided additional input as follows:

- Incorporate a periodic update of the BMR program every few years.
- With an alternative mitigation, a goal should be to house as many people as possible.
- On-site BMR units is a priority.
- A goal is get more ownership units.
- If an applicant seeks an alternative mitigation to build the BMR units off-site, the off-site units should not lead to or exacerbate segregation.
- Prefers to have BMR units float and not in fixed locations to provide flexibility.

<u>SUMMARY OF COUNCIL QUESTIONS</u>

- *Question No. 1: Does Council support a higher BMR requirement for rowhouse/townhouse projects, up to 25 percent?*
- *Question No. 2: Does Council support the recommended BMR on-site requirements for rental and for-sale projects, including BMR units in perpetuity?*
- *Question No. 3: Does Council support the recommendations regarding alternative mitigations?*

- *Question No. 4: Does Council seek to facilitate the delivery of BMR units on-site by setting the fee level equivalent to the value of on-site units (calculated at $96 per net habitable square foot for rental projects and $54.50 per net habitable square foot for for-sale projects)?*

- *Question No. 5: Does Council agree with the exemption provision for Phase 2 modifications noted above?*

- *Question No. 6: Does Council support the two-tiered approach outlined above for ongoing tenant eligibility?*

- *Question No. 7: Does Council have input on other components of Phase 2 modifications?*

RECOMMENDATION

Staff seeks input and direction from the City Council regarding Phase 2 modifications.

NEXT STEPS

Input and direction from Council will be used to develop final BMR Phase 2 modifications and Ordinance amendments for public hearing. Next steps for Phase 2 modifications are as follows:

- May 30, 2019—EPC Public Hearing

- June 18, 2019—Council First Reading

- June 25, 2019—Council Second Reading

- August 24, 2019—Effective Date (if Council seeks a 60-day period after second reading)

PUBLIC NOTICING

This Study Session was publicly noticed in the *Daily Journal* and postcards were sent to all interested parties that signed up for information on the BMR program through the City's "E-zine" mailing list program.

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Attachments:
1. Draft BMR Phase 2 Guidelines
2. February 13, 2018 Council Report
3. Existing BMR Guidelines
4. March 21, 2019 Community Meeting Notes