PRELIMINARY DRAFT

Affordable Housing In-Lieu Fee Nexus Study

City of Sebastopol

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Prepared for:

Prepared by:

Harris & Associates

1401 Willow Pass Road, Suite 500
Concord, CA 94520
(925) 827-4900

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Executive Summary

INTRODUCTION

The City of Sebastopol (City) retained Harris & Associates (Harris) to prepare an Affordable Housing In-Lieu Fee Study (Study) in order to update the previously adopted Affordable Housing In-Lieu Fee (Fee) contained in Ordinance 1111 adopted in 2018. The City's current inclusionary in-lieu fee was adopted in July 2006. The City updated their Affordable Housing Ordinance in 2018 changing the inclusionary requirements and allowing additional flexibility to developers. This study will update the City's inclusionary in-lieu fee to match the updated policy.

The purpose of this report is to provide information to the City of Sebastopol (City) for its consideration in updating the Fee component of the City's Inclusionary Housing Ordinance (Ordinance). The Fee is part of the City's Inclusionary Housing Policy (Policy) and is an option for developers to satisfy their inclusionary housing requirement when the requirement results in a fractional inclusionary unit.

Harris & Associates has reviewed the current fees, analyzed the City's current inclusionary ordinance, updated build costs, and incorporated the County's Area Median Income (AMI) numbers for 2020. The updating of these data will create an 'affordability gap', which represents the difference between what is affordable to a lower income household and the costs of developing an affordable housing unit in the City. The affordability gap represents the amount that must be provided through special financing, public or private subsidies, or other sources such as an in-lieu fee, to make housing affordable to very low, low, and moderate-income households. The Fees in this Study represent the fees supported but do not represent specific Fee recommendations. The City has the latitude to adopt the Fees deemed appropriate.

FINDINGS AND METHODOLOGY

The existing in-lieu fee is based on the requirements of an outdated Inclusionary Housing Ordinance. The City updated its Inclusionary Housing Ordinance in 2018 and this study will update the inclusionary in-lieu fee to align with the updated City Ordinance.

The City's 2018 inclusionary housing policy (Policy) applies to projects of five (5) units or more. The Policy requires 15% of a development to be provided at prices affordable to moderate-income (120% AMI) households, or 10% of units affordable to low-income (80% of AMI) households, or 5% of units affordable to very low-income (50% of AMI). The Ordinance and fractional in-lieu Fee are designed to mitigate the impact of an increase in demand for affordable housing from the development of new market-rate residential units.

Table E.1 shows the inclusionary unit equivalent fees using the analysis in this report. The report will give detailed calculations on how these fees are calculated in the following sections.

Table E.1: Inclusionary Unit Equivalent Fee

Income Level	Inclusionary Unit Fee For-Sale	Inclusionary Unit Fee For-Rent
Very Low-Income	$ 436,586	$ 331,903
Low-Income	$ 278,872	$ 220,858
Moderate-Income	$ 149,931	$ 115,625

Sources: Table 8 and Table 9.

The inclusionary unit fee is available to developers when a project's inclusionary housing requirement has a fractional unit requirement. The City's Policy states that required whole units will be constructed as part of the development and any fractional units may be rounded up to the next whole number and constructed or the project may pay an in-lieu fee for the fractional units. An example 16 unit development that opts for moderate-income inclusionary housing is required to provide 2.4 units (16 units x 15% inclusionary requirement) at prices affordable to households at 120% AMI. This project could construct two units and pay a fee of $59,972.40 (0.4 units x $149,931 Inclusionary Unit Equivalent Fee) if the project is for-sale and $46,250.00 (0.4 units x $115,625 Inclusionary Unit Equivalent Fee) if the project is for-rent or they could build three affordable units.

The inclusionary unit equivalent fee represents the difference between what very low, low, and moderate-income households can afford to pay for housing and the cost to develop and service affordable housing in the City. This difference is known as the 'affordability gap.' For rental affordable units, the net income available from lower-income households is used to determine the supportable debt and is compared with unit development costs to calculate the affordability gap. For-sale units calculate the maximum affordable mortgage for lower-income households compared to the development cost of affordable housing in the City.

To estimate future market-rate housing development in the City, Harris staff researched and reviewed new residential development projects in the City, Multiple Listing Service (MLS) data showing recently constructed units, information from City staff to identify recent market trends related to home prices, and academic and building industry publications. The Fees calculated in this Study reflect the estimated cost of future residential development.

POLICY CONSIDERATIONS

The City should evaluate several policy considerations and implications related to the in-lieu fees. Harris & Associates reviewed the supportable Fees for consistency with the Housing Policy outlined in the City's Inclusionary Ordinance.

Housing Policy Consistency

The Inclusionary Housing Ordinance, adopted in 2018, discusses the current affordable housing issues that exist within the City and details the City's existing Inclusionary Housing Program. The

Fees in this study are consistent with the City's goal of providing opportunities for the development of adequate housing for households of all income levels.

To be consistent with City housing policy, the household income categories addressed in this analysis are:

- Very Low-Income (<50% AMI)
- Low-Income (51-80% AMI)
- Moderate-Income (81-120% AMI)

Role of Fee in Overall Housing Strategy

Affordable housing in Sebastopol is funded through a variety of sources, including funding provided by the City and Sonoma County, as well as direct and indirect financing provided by the state and federal government. Inclusionary fee revenues would augment other affordable housing funding sources.

Section 1 INTRODUCTION AND METHODOLOGY

Introduction

The City of Sebastopol (City) retained Harris & Associates (Harris) to prepare an Affordable Housing In-Lieu Fee Study (Study) in order to update the previously adopted Affordable Housing In-Lieu Fee (Fee) contained in Ordinance 1111. The City's current inclusionary in-lieu fee was adopted in July 2006. The City's inclusionary housing policy at that time required 20% of a project to be sold or rented at a price affordable to households earning 80% or less of the Area Median Income (AMI). The City updated this policy in 2018 changing the inclusionary requirements and allowing additional flexibility to developers. This study will update the City's inclusionary in-lieu fee to match the updated policy.

The City is updating the Inclusionary Housing In-Lieu Fee for new residential development to offer developers the option to pay an in-lieu fee for fractional units that are required under the inclusionary ordinance as part of any new residential development project of five units or more.

While In-Lieu Fees are just one of several funding mechanisms that jurisdictions can use to mitigate affordable housing needs, they are a proven method of funding, as various California cities and counties have implemented inclusionary housing fee programs. The revenues collected through the Fee are to be deposited into a housing fund specifically reserved for the funding of affordable housing within the City.

The City's inclusionary housing policy (Policy) applies to projects of five units or more. The Policy requires 15% of a development to be provided at price affordable to moderate-income (120% AMI) households, or 10% of units affordable to low-income (80% of AMI) households, or 5% of units affordable to very low-income (50% of AMI). The dedicated units are required to be deed-restricted as affordable units for a period of 55 years.

The first portion of the analysis determines the demand for affordable housing units at various income levels to calculate the "affordability gap." For ownership housing units, the sales price needed for units to be affordable to very low, low, and moderate-income households is compared to the cost to develop these units to calculate the "affordability gap." For rental units, the development cost is compared with income sources available to service debt for affordable housing to determine the "affordability gap."

Background

This section discusses the City's historical Inclusionary Housing Policy and the results of recent legislation and judicial rulings.

City’s Inclusionary Housing Ordinance

The City has historically used an Inclusionary Housing Policy originally established by Ordinance 1111 to generate affordable housing in proportion with the overall increase in market-rate residential units and is described in the Housing Element of the City’s General Plan. The Policy requires the following for housing projects with five or more units:

- Fifteen percent (15%) of the units shall be inclusionary units affordable to households earning 120 percent or less of AMI; or
- Ten percent (10%) of the units shall be inclusionary units affordable to households earning 80 percent or less of AMI; or
- Five percent (5%) of the units shall be inclusionary units affordable to households earning 50 percent or less of AMI.

The current Policy allows developers to pay an Affordable Housing Payment in-lieu of providing a fractional unit equal to the applicable decimal fraction times the established in-lieu fee for one inclusionary unit.

Legal Framework

In 2009, the Court of Appeals struck down a City of Los Angeles ordinance imposing inclusionary housing requirements on rental housing projects with a density of more than 10 dwelling units per lot. The Courts’ decision that regulating the rent levels to ensure the units were affordable directly violated the provisions of the Costa-Hawkins Act. Jurisdictions were unable to require affordable housing units at affordable rental rates as a condition of project approval because of this decision.

In 2015, the California Supreme Court ruled in favor of the City of San Jose in a court case involving the California Building Industry Association (Association). The Association challenged the legality of San Jose’s inclusionary program on the basis that it constituted an “exaction” that required a nexus study. The court deemed that San Jose’s inclusionary program was not an exaction and it constituted a valid exercise of the City’s power to regulate land use.

Finally, in 2017, a package of housing related bills was passed, which included AB 1505, commonly referred to as the “Palmer Fix”. AB 1505 allows jurisdictions to adopt ordinances that require a percentage of residential rental units to be affordable to individuals whose income falls below the moderate-income level for the jurisdiction. Additionally, AB 1505 requires jurisdictions to provide alternative methods for developers to satisfy their affordable housing requirements, which may include in-lieu fees, off-site construction, land dedication, or acquisition and rehabilitation of existing units. AB 1505 also imposes specific standards on any county or city with an inclusionary housing policy requiring greater than 15% of a project to be provided as affordable units.

Methodology

Nexus Analysis

Residential development projects contribute to population growth. As the population grows, additional services and facilities are needed to accommodate the residential population influx. To meet the increased demands of population growth, new non-residential development will occur, correlating to an increase in the worker population. A portion of the new worker population will earn a wage that is not sufficient to rent or purchase market-rate housing. The Study analyzes the supported Fee to address the affordable housing need created by new residential development. The Fee will be used to build affordable housing to address the demand generated.

The methodology utilized in this nexus analysis complies with general best practices related to nexus studies and follows the following order, specific data points are explained in the following sections of this study. This nexus analysis is broken down into the steps described below.

Step 1: Determine the type of units to be developed

Harris & Associates coordinated with City staff, local real estate professionals, and a sampling of planned and current recently developed housing types to determine the likely characteristics of new affordable residential units developed in the City and determined the likely affordable development will all be multifamily units.

Step 2: Determine the amount that very low, low, and moderate-income households can afford to spend on housing.

Using the area median income (AMI), the maximum a household can spend on housing can be calculated. Per Sebastopol's Affordable Housing Ordinance, a maximum of 30% of household income can be used for the calculation of affordable housing. This amount does not include an allowance for utilities, property taxes, insurance, or maintenance. This amount represents the maximum affordable housing cost. Using monthly housing costs, the maximum mortgage amount can be calculated.

Step 3: Calculate the Supportable Debt of For-Rent Units

For-rent units use a project's supportable debt amount to determine what is the affordable price for a multifamily unit. Rental projects have property expenses that affect the cash flow available for debt service, and the debt service requirements on nonresidential projects are different than that of standard residential mortgages.

Step 4: Calculate Development Costs of Affordable Units

The next step in calculating the affordability gap is to determine the cost to develop an affordable unit in the City. Costs are determined by examining current development costs related to unit type and size, the City's Policy, and recent land transactions. As the development, sale, and operations associated with for-rent and for-sale units vary, an analysis of each housing type was required.

Step 5: Calculate the Affordability Gap

The affordability gap can now be calculated by using the difference between the cost to develop a for-sale unit and what households at very low, low, and moderate incomes can afford as a mortgage (step 2). The for-rent affordability gap is calculated using the difference between the supportable debt and the cost to develop the units (step 4).

Step 6: Calculate the Supported Fee

The inclusionary equivalent Fee calculation for each housing type in this study is the affordability gap (Step 5) for each housing type. The fee for the fractional unit is calculated by multiplying the affordability gap by the fractional unit requirement.

Section 2 AFFORDABILITY GAP ANALYSIS

A key input required in the calculation of the supported fractional in-lieu Fees is the affordability gap. The affordability gap is the difference between what very low, low, and moderate-income households can afford to pay to buy or rent housing versus the total cost of developing and servicing the units. This section summarizes the methodology used to calculate the affordability gap and presents the results of this analysis for the respective unit type. For eligibility purposes, the City defines very low income as those earning less than 50 percent of the area median income (AMI), low-income households as those earning between 51 percent and 80 percent of AMI, and moderate-income as those earning between 81 percent and 120 percent of AMI.

Methodology

The following section details the findings for affordable housing rates, total development costs of units in the City, and a summary of the affordability gap by unit type. Calculating the housing affordability gap for rental units involves the following three steps:

1. Estimate the housing costs that are affordable for households in target income groups from Table 1.

2. Estimate development and servicing costs of building new affordable housing units, based on current cost and market data.

3. Calculate the difference between what very low and low-income households can afford to pay for housing and the cost of developing and servicing affordable housing units.

The housing affordability gap calculation for ownership units involves the following three steps:

1. Estimate the affordable monthly maximum mortgage affordable to very low, low, and moderate-income households from Table 1.

2. Estimate the development costs of new affordable housing units.

3. Calculate the difference between what moderate-income households can afford to pay for housing and the cost of development of affordable housing units.

Affordable Housing Rates

Prior to determining the affordability gap, the total amount that households can afford to allocate to their housing must be determined. For this report, the income levels included in the City's Inclusionary Housing Ordinance have been included in the analysis and are defined as:

- Moderate-income households earning 120 percent or less of AMI
- Low-income households earning 80 percent or less of AMI
- Very low-income households earning 50 percent or less of AMI.

The area median income is defined by the Department of Housing and Urban Development (HUD) for Sonoma County. Table 1 shows the AMI for various household sizes.

Table 1: Threshold Incomes and percent of Area Median Income (AMI)

	Persons per Household					
	1	**2**	**3**	**4**	**5**	**6**
30% AMI	$ 23,900	$ 27,300	$ 30,700	$ 34,100	$ 36,850	$ 39,600
50% AMI	$ 39,800	$ 45,450	$ 51,150	$ 56,800	$ 61,350	$ 62,650
80% AMI	$ 63,650	$ 72,750	$ 81,850	$ 90,900	$ 98,200	$ 105,450
100% AMI	$ 71,900	$ 82,150	$ 92,450	$ 102,700	$ 110,900	$ 119,150
120% AMI	$ 86,300	$ 98,600	$ 110,950	$ 123,250	$ 133,100	$ 142,950

1) California Department of Housing and Community Development July 2, 2020.

Housing affordability of rental and ownership units is defined by the City's Ordinance as 30% of gross income and states that the cost of utilities, property taxes, insurance, homeowner's dues, and the like shall not be included in the calculation of housing costs.

Because income levels for affordable housing programs vary by household size, calculating affordable rent requires a defined household size. Unit occupancy is calculated consistent with California Health and Safety Code Section 50052.5(h). Table 2 outlines the maximum available housing cost calculations for each income bracket and persons per household (PPH) category. All units being constructed are assumed to be multifamily housing. This will be a mix of studio, one-bedroom, two-bedroom, and three-bedroom units to represent the mix of units required for a diverse mix of household sizes. The maximum monthly housing cost on Table 2 is the maximum affordable rent for each income level.

Table 2: Maximum Affordable Housing Cost by Income Level

Income Level and Unit Type	Persons per Household	Household Income[1]	Maximum Monthly Housing Cost[2]
Very Low Income (50% AMI)			
One Bedroom	2	$ 45,450	$ 1,136
Two Bedroom	3	$ 51,150	$ 1,279
Three Bedroom	4	$ 56,800	$ 1,420
Four Bedroom	5	$ 61,350	$ 1,534
Low Income (80% AMI)			
One Bedroom	2	$ 72,750	$ 1,819
Two Bedroom	3	$ 81,850	$ 2,046
Three Bedroom	4	$ 90,900	$ 2,273
Four Bedroom	5	$ 98,200	$ 2,455
Moderate Income (120% AMI)			
One Bedroom	2	$ 98,600	$ 2,465
Two Bedroom	3	$ 110,950	$ 2,774
Three Bedroom	4	$ 123,250	$ 3,081
Four Bedroom	5	$ 133,100	$ 3,328

1) California Department of Housing and Community Development July 2, 2020.

2) 30% of gross income per Sebastopol Municipal Code 17.250.

Table 3 shows the maximum affordable mortgage and purchase price for very low, low, and moderate-income households.

Table 3: Maximum Affordable Mortgage and Purchase Price by Income Level

Income Level and Unit Type	Persons per Household	Household Income[1]	Maximum Monthly Mortgage[2]	Maximum Mortgage Amount[3]	Maximum Purchase Price[4]
Very Low Income (50% AMI)					
One Bedroom	2	$ 45,450	$ 1,136	$ 200,118	$ 222,353
Two Bedroom	3	$ 51,150	$ 1,279	$ 225,216	$ 250,240
Three Bedroom	4	$ 56,800	$ 1,420	$ 250,093	$ 277,881
Four Bedroom	5	$ 61,350	$ 1,534	$ 270,127	$ 300,141
Low Income (80% AMI)					
One Bedroom	2	$ 72,750	$ 1,819	$ 320,321	$ 355,912
Two Bedroom	3	$ 81,850	$ 2,046	$ 360,389	$ 400,432
Three Bedroom	4	$ 90,900	$ 2,273	$ 400,237	$ 444,708
Four Bedroom	5	$ 98,200	$ 2,455	$ 432,379	$ 480,421
Moderate Income (120% AMI)					
One Bedroom	2	$ 98,600	$ 2,465	$ 434,140	$ 482,378
Two Bedroom	3	$ 110,950	$ 2,774	$ 488,518	$ 542,798
Three Bedroom	4	$ 123,250	$ 3,081	$ 542,675	$ 602,972
Four Bedroom	5	$ 133,100	$ 3,328	$ 586,045	$ 651,161

1) California Department of Housing and Community Development July 2, 2020.

2) 30% of gross income per Sebastopol Municipal Code 17.250.

3) Assumes 30 year term at 5.5% interest.

4) Assumes a 10% down payment per Sebastopol Municipal Code 17.250.

The development costs and maximum mortgage amounts are used as the basis of the for-sale affordability gap, but for-rent units require an additional calculation. For-rent unit's affordability gap is defined as the difference between development costs and the first mortgage amount that can be supported by the net operating income (NOI) based on affordable rents. See Table 4 for the calculation of the supportable debt.

Table 4: Supportable Debt Calculation on For-Rent Units

Income Level and Unit Type	Persons per Household	Household Income	Maximum Monthly Rent[1]	Annual Rental Income	Net Operating Income[2]	Revenue Available for Debt Service[3]	Supportable Debt[4]
Very Low Income (50% AMI)							
One Bedroom	2	$ 45,450	$ 1,136	$ 13,635	$ 9,453	$ 8,220	$ 114,255
Two Bedroom	3	$ 51,150	$ 1,279	$ 15,345	$ 11,078	$ 9,633	$ 133,890
Three Bedroom	4	$ 56,800	$ 1,420	$ 17,040	$ 12,688	$ 11,033	$ 153,352
Four Bedroom	5	$ 61,350	$ 1,534	$ 18,405	$ 13,985	$ 12,161	$ 169,025
Low Income (80% AMI)							
One Bedroom	2	$ 72,750	$ 1,819	$ 21,825	$ 17,234	$ 14,986	$ 208,293
Two Bedroom	3	$ 81,850	$ 2,046	$ 24,555	$ 19,827	$ 17,241	$ 239,639
Three Bedroom	4	$ 90,900	$ 2,273	$ 27,270	$ 22,407	$ 19,484	$ 270,813
Four Bedroom	5	$ 98,200	$ 2,455	$ 29,460	$ 24,487	$ 21,293	$ 295,958
Moderate Income (120% AMI)							
One Bedroom	2	$ 98,600	$ 2,465	$ 29,580	$ 24,601	$ 21,392	$ 297,336
Two Bedroom	3	$ 110,950	$ 2,774	$ 33,285	$ 28,121	$ 24,453	$ 339,877
Three Bedroom	4	$ 123,250	$ 3,081	$ 36,975	$ 31,626	$ 27,501	$ 382,246
Four Bedroom	5	$ 133,100	$ 3,328	$ 39,930	$ 34,434	$ 29,942	$ 416,175

1) Table 2.

2) Assumes a 5% vacancy and $3,500 per unit in operating expenses including management, taxes, insurance, and maintenance.

3) Maximum debt using a 1.15 debt service coverage ratio per California Housing and Community Development Uniform Multifamily Regulations, 2017 update.

4) Assumes a 30 year term and 6% interest rate.

Affordable Development Cost Estimates

Next, the estimated cost of developing affordable housing units was determined by examining current development trends related to unit type and size. As the development, sale, and operations associated with for-rent and for-sale units vary, an analysis of each housing type was required. Single family units in Sebastopol tend to be significantly more expensive than multifamily units. For purposes of this analysis, it is assumed all City-led construction projects will be multifamily developments and as such only multifamily development costs have been calculated.

This study uses the baseline density assumption of 25 units per acre as directed by the City. Included in the total cost of developing new units are land acquisition costs, hard costs (direct improvements), soft costs (design, permits, fees, etc.), a prevailing wages cost increase, developer fees, and financing costs. These cost estimates were populated using data from a Multiple Listing Service and Commercial Sale Survey completed in November of 2020, as well as the *"Making It Pencil: The Math Behind Housing Development"* report published by the Terner Center for Housing Innovation at the University of California, Berkley. As these projects are assumed to have federal and state funding, all labor costs are required to meet the prevailing wage requirements.

Table 5 shows the per square foot development cost and land costs of for-rent multifamily units, pursuant to the requirements in the City's existing Inclusionary Housing Ordinance.

Table 5: Development Costs – For-Rent Affordable Units

Assumed Density	A		25 Units/Acre
Land Acquisition Cost ($/Acre) [1]	B	$	1,012,000.00
Land Price per Unit	**B ÷ A = C**	**$**	**40,480.00**
Development Costs [2]			
Building Hard Costs ($/SF)	D	$	250.00
Prevailing Wage Cost Increase (35%)	D x 0.35 = E	$	87.50
Soft Costs (30%) [3]	D x 0.30 = F	$	75.00
Developer Fees (12%)	(D + E + F) x 0.12	$	49.50
Financing Costs (10%)	(D + E + F) x 0.10	$	41.25
Total Development Costs per SF		**$**	**503.25**

1) Per Multiple Listing Service survey and tax record search of vacant land sales completed December 2019.

2) "Making It Pencil: The Math Behind Housing Development." Aug. 2019, www.TernerCenter.Berkeley.Edu, escalated by CCI.

3) Includes design, engineering, city permits and fees, and contingencies.

Table 6: Development Costs – For-Sale Affordable Units

Assumed Density	A		25 Units/Acre
Land Acquisition Cost ($/Acre) [1]	B	$	1,012,000.00
Land Price per Unit	**B ÷ A = C**	**$**	**40,480.00**
Development Costs [2]			
Building Hard Costs ($/SF)	D	$	275.00
Prevailing Wage Cost Increase (35%)	D x 0.35 = E	$	96.25
Soft Costs (30%) [3]	D x 0.30 = F	$	82.50
Developer Fees (12%)	(D + E + F) x 0.12	$	54.45
Financing Costs (10%)	(D + E + F) x 0.10	$	45.38
Total Development Costs per SF, Rounded		**$**	**553.58**

1) Per Multiple Listing Service survey and tax record search of vacant land sales completed December 2019.

2) "Making It Pencil: The Math Behind Housing Development." Aug. 2019, www.TernerCenter.Berkeley.Edu, escalated by CCI.

3) Includes design, engineering, city permits and fees, and contingencies.

The estimated unit size (square footage) is multiplied by the total development cost per square foot to determine the building cost. Then, the estimated land cost per unit is added to calculate the total development cost for each unit type, as seen in Table 7. Rental square footages are based on the City's Inclusionary Ordinance minimum size requirements, for-sale square footages are from a Multiple Listing Service (MLS) survey of all Sonoma County multifamily transactions in 2020.

Table 7: Unit Cost Summary

Unit Development Cost	Unit Size [1,2]	Build Costs, Rounded	Land Costs	Total Development Costs
For-Rent Units				
1 Bedroom Unit	600	$ 301,950	$ 40,480	$ 342,430
2 Bedroom Unit	750	$ 377,438	$ 40,480	$ 417,918
3 Bedroom Unit	900	$ 452,925	$ 40,480	$ 493,405
4 Bedroom Unit	1,200	$ 603,900	$ 40,480	$ 644,380
For-Sale Units				
1 Bedroom Unit	650	$ 359,827	$ 40,480	$ 400,307
2 Bedroom Unit	1,065	$ 589,563	$ 40,480	$ 630,043
3 Bedroom Unit	1,345	$ 744,565	$ 40,480	$ 785,045
4 Bedroom Unit	1,700	$ 941,086	$ 40,480	$ 981,566

1) For-rent unit sizes per Sebastopol Municipal Code 17.250.

2) For-sale unit sizes per MLS survey of all multifamily property transactions in Sonoma County in 2020, rounded.

Affordability Gap Analysis

The differences between the total amount that each targeted income level can afford to allocate for housing (Table 3, Table 4) and the total cost of developing new units (Table 6) determines the Affordability Gap. This difference represents the fee amount that is necessary to cover the costs of developing housing at each of the respective income levels analyzed. While other funding sources may be available to assist in mitigating this difference between affordability and development costs, these sources are very difficult to predict with accuracy moving forward.

The City's current Ordinance has the following inclusionary requirements:

- Fifteen percent (15%) of the units shall be inclusionary units affordable to households earning 120 percent or less of AMI; or
- Ten percent (10%) of the units shall be inclusionary units affordable to households earning 80 percent or less of AMI; or
- Five percent (5%) of the units shall be inclusionary units affordable to households earning 50 percent or less of AMI.

The affordability gap for rental units is the difference between the development costs and the maximum supported debt for each income level, shown in Table 8.

Table 8: Affordability Gap –For-Rent Units

Income Level and Unit Type	Persons per Household	Household Income	Supportable Debt[1]	Development Cost[2]	Affordability Gap
Very Low Income (50% AMI)					
One Bedroom	2	$ 45,450	$ 114,255	$ 342,430	$ 228,175
Two Bedroom	3	$ 51,150	$ 133,890	$ 417,918	$ 284,028
Three Bedroom	4	$ 56,800	$ 153,352	$ 493,405	$ 340,053
Four Bedroom	5	$ 61,350	$ 169,025	$ 644,380	$ 475,355
Average Affordability Gap					**$ 331,903**
Low Income (80% AMI)					
One Bedroom	2	$ 72,750	$ 208,293	$ 342,430	$ 134,137
Two Bedroom	3	$ 81,850	$ 239,639	$ 417,918	$ 178,279
Three Bedroom	4	$ 90,900	$ 270,813	$ 493,405	$ 222,592
Four Bedroom	5	$ 98,200	$ 295,958	$ 644,380	$ 348,422
Average Affordability Gap					**$ 220,858**
Moderate Income (120% AMI)					
One Bedroom	2	$ 98,600	$ 297,336	$ 342,430	$ 45,094
Two Bedroom	3	$ 110,950	$ 339,877	$ 417,918	$ 78,041
Three Bedroom	4	$ 123,250	$ 382,246	$ 493,405	$ 111,159
Four Bedroom	5	$ 133,100	$ 416,175	$ 644,380	$ 228,205
Average Affordability Gap					**$ 115,625**

1) Table 2.

2) Assumes a 5% vacancy and $5,000 per unit in operating expenses including taxes, insurance, and maintenance.

3) Assumes a 1.15 debt coverage ratio.

1) Table 4.

2) Table 7.

Using the inclusionary requirements, Table 9 shows the for-sale affordability gap calculation.

Table 9: Affordability Gap – For-Sale Units

Income Level and Unit Type	Persons per Household	Maximum Mortgage Amount[1]	Allowable Down Payment[2]	Maximum Purchase Price	Development Cost[3]	Affordability Gap
Very Low Income (50% AMI)						
One Bedroom	2	$ 200,118	$ 22,235	$ 222,353	$ 400,307	$ 177,954
Two Bedroom	3	$ 225,216	$ 25,024	$ 250,240	$ 630,043	$ 379,803
Three Bedroom	4	$ 250,093	$ 27,788	$ 277,881	$ 785,045	$ 507,164
Four Bedroom	5	$ 270,127	$ 30,014	$ 300,141	$ 981,566	$ 681,425
Average Affordability Gap						**$ 436,586**
Low Income (80% AMI)						
One Bedroom	2	$ 320,321	$ 35,591	$ 355,912	$ 400,307	$ 44,395
Two Bedroom	3	$ 360,389	$ 40,043	$ 400,432	$ 630,043	$ 229,611
Three Bedroom	4	$ 400,237	$ 44,471	$ 444,708	$ 785,045	$ 340,337
Four Bedroom	5	$ 432,379	$ 48,042	$ 480,421	$ 981,566	$ 501,145
Average Affordability Gap						**$ 278,872**
Moderate Income (120% AMI)						
One Bedroom	2	$ 434,140	$ 48,238	$ 482,378	$ 400,307	$ -
Two Bedroom	3	$ 488,518	$ 54,280	$ 542,798	$ 630,043	$ 87,245
Three Bedroom	4	$ 542,675	$ 60,297	$ 602,972	$ 785,045	$ 182,073
Four Bedroom	5	$ 586,045	$ 65,116	$ 651,161	$ 981,566	$ 330,405
Average Affordability Gap						**$ 149,931**

1) Table 3.

2) 10% down payment per Sebastopol Municipal Code 17.250.

3) Table 7.

Section 3 FINDINGS AND POLICY CONSIDERATIONS

This section presents the inclusionary unit Fee, which is calculated by following the methodology outlined in Section 1 and using the results from the affordability gap analysis detailed in Section 2.

Fee Calculation

The supported Fees are calculated by averaging the multiplication result of the affordability gap by unit type and at affordability levels required by the City's Inclusionary Housing Ordinance. Table 10 shows the calculation of the inclusionary equivalent in-lieu fee for each income level.

Table 10: Inclusionary Unit Equivalent Fee Calculation

	Inclusionary Unit Fee	
Income Level	**For-Sale**	**For-Rent**
Very Low-Income	$ 436,586	$ 331,903
Low-Income	$ 278,872	$ 220,858
Moderate-Income	$ 149,931	$ 115,625

Sources: Table 8 and Table 9.

The inclusionary unit fee is available to developers when a project's inclusionary housing requirement has a fractional unit requirement. The City's Policy states that required whole units will be constructed as part of the development and any fractional units may be rounded up to the next whole number and constructed or the project may pay an in-lieu fee for the fractional units. An example 16 unit development that opts for moderate-income inclusionary housing is required to provide 2.4 units (16 units x 15% inclusionary requirement) at prices affordable to households at 120% AMI. This project could construct two units and pay a fee of $59,972.40 (0.4 units x $149,931 Inclusionary Unit Equivalent Fee) if the project is for-sale and $46,250.00 (0.4 units x $115,625 Inclusionary Unit Equivalent Fee) if the project is for-rent or they could build three (3) affordable units.

Adopting a fee to be collected from new development should be consistent with other City policies and should not have measurable impacts on the development community.

Housing Policy Consistency

The City updated its inclusionary housing policy in 2018. Updating the affordable housing in-lieu fee enables the City to partially mitigate affordability issues for future development by providing housing for households in the very low, low, and moderate-income categories.

The Policy requires the following for housing projects with five or more units:

- Fifteen percent (15%) of the units shall be inclusionary units affordable to households earning 120 percent or less of AMI; or

- Ten percent (10%) of the units shall be inclusionary units affordable to households earning 80 percent or less of AMI; or
- Five percent (5%) of the units shall be inclusionary units affordable to households earning 50 percent or less of AMI.

The current Policy allows developers to pay an in-lieu Affordable Housing Payment to meet the requirements for fractional inclusionary units.

BENEFIT TO THE CITY'S OVERALL AFFORDABLE HOUSING STRATEGY

The revenues to be collected from an Inclusionary Housing In-Lieu Fee provide an important source of local funding; however, fee revenues do not generally cover the entire funding gap encountered by sponsors of new affordable housing. Additional funding is usually required.

Currently, affordable housing in the City is funded using a variety of financing sources, including funding provided by the City, Sonoma County, the state, or the federal government. In addition, equity is also provided directly by developers and indirectly raised through the allocation and sale of Low Income Housing Tax Credits. Finally, a portion of permanent financing comes from conventional loans obtained from private lending institutions.

In-lieu fees would augment existing affordable housing funds. The existence of a local revenue source such as impact fees can also make certain projects more competitive for outside funding.

FEE ADJUSTMENTS

Similar to any impact fee, the fee should be adjusted annually for inflation and increases in construction costs. Adjustments are also needed due to possible changes in the housing affordability gap.

The City should adjust its inclusionary in-lieu fee annually by using an annual adjustment mechanism. An adjustment mechanism updates the fees to compensate for inflation in development costs. Adjusting the fee for annual inflation by the Construction Cost Index published in the Engineering News-Record (ENR) will represent the annual increases in construction costs. Cost index information for the San Francisco area, the closest geographical area to the City, should be used as the annual inflator.

In addition to revising the fee annually for inflation, the City is encouraged to update the Study every five years, or at the very least, update the housing affordability gap used in the basic model. The purpose of these updates is to ensure that the fee is still based on a cost/revenue structure that remains applicable in the Sebastopol housing market. In this way, the fee will more accurately reflect any structural changes between affordable prices/rents and market-rate sales prices/development costs.

Conclusion

Inclusionary Housing Fractional In-Lieu Fees, along with other development impact fees, are a necessary tool to allow development to 'pay its own way' and offset the impacts created by new development. The revenues generated by the in-lieu fees, in conjunction with other funding sources, can help mitigate the City's affordable housing need. Fractional in-lieu fees allow developers to meet City requirements when building additional units may not be an option.