Public Hearing to Provide Direction on Recommendations Regarding Amending the City's Inclusionary Affordable Housing Ordinance and Adding a "Middle Income" Housing Requirement. (Community Development 481005)

To: Honorable Mayor and Members of the City Council

From: Jill Keimach, City Manager

Re: Public Hearing to Provide Direction on Recommendations Regarding Amending the City's Inclusionary Affordable Housing Ordinance and Adding a "Middle Income" Housing Requirement

BACKGROUND

On June 16, 2016, the City Council directed staff and the Planning Board to consider revisions of Alameda's Inclusionary Housing requirements to:

- Increase the overall percentage of required affordable units as defined by the current Housing Element of Alameda's General Plan and State housing laws within residential developments; and
- Add a "work force housing" requirement as part of the affordable housing requirement.

The City Council further asked that the recommendations from staff and the Planning Board consider alternatives that would not require an increase in the total number of units allowed by zoning and that the changes help Alameda meet its Regional Housing Need Allocation (RHNA) for affordable units. The referral is attached as Exhibit 1.

On July 24, 2017, the Planning Board reviewed the staff analysis included in this report and added its own perspective on the issue of affordable housing in Alameda. The Planning Board's recommendations and suggestions are included below before the staff recommendation.

DISCUSSION

The City Council's 2016 referral statement that due to, *"the high home prices and rents in Alameda, low and even middle income households are in need of increased opportunities in new developments"* reflects a long-standing policy objective of the Alameda City Council to increase affordable housing opportunities in Alameda that goes back at least 14 years:

- In 2003, the City Council adopted the Inclusionary Housing Ordinance which requires that each residential project include at least 15% of the units with deed restrictions ensuring affordability for very low-, low- and moderate-income households. Inclusionary housing ordinances are not required by the State of California to meet the City's RHNA obligations.

- In 2010, the City Council adopted the Density Bonus Ordinance, which grants density bonuses to projects that provide affordable housing units that exceed the City's Inclusionary Housing Ordinance requirements. The Density Bonus Ordinance is required by State Law.

- In 2012, the City Council adopted a comprehensive set of amendments to the General Plan Housing and Land Use Elements and Alameda Municipal Code (AMC) and zoning regulations specifically designed to bring the City of Alameda into conformance with State of California Housing law regarding the development of affordable housing. The amendments included adoption of the Multifamily (MF) Overlay Zoning designation on several key housing opportunity sites in Alameda.

- In 2014, the City Council adopted a revised Housing Element to address the City's RHNA obligations for the 2015 through 2023 period, which the State of California certified as in compliance with State Law. The City of Alameda is currently in conformance with State Law and in compliance with its RHNA obligations.

- In 2015, the Council initiated efforts to require "middle income" or "work force" housing on a project-by-project basis. Site A at Alameda Point, approved in 2015, was the first project to include project-specific requirements for smaller, "affordable by design" units that might be affordable to middle income home buyers and renters. The recently approved Alameda Landing Master Plan amendments require that at least 10% of the units meet middle income, "affordable by design" standards. The proposals for Encinal Terminals and Alameda Marina both include affordable by design, middle income units requirements.

- In 2017, the City Council approved the Main Street Specific Plan for the Main Street District at Alameda Point, which includes "middle income" market rate housing provisions in addition to inclusionary housing requirements. The Specific Plan represents the Council's first decision to address "middle income" market rate housing needs on an area-wide basis through adoption of zoning requirements.

- In 2017, the City Council approved a comprehensive set of amendments to the City of Alameda Accessory Dwelling Unit Ordinance to bring the City's code into conformance with recent state laws specifically designed to increase the supply of smaller, more affordable, market rate units.

The balance of the staff report addresses Council's direction to consider options for achieving additional affordable housing, including more middle income housing, without increasing the overall amount of new residential development.

Considerations for increasing the 15% deed restricted inclusionary housing requirement. AMC Section 30-16 Inclusionary Housing Requirements for Residential Projects currently requires that all residential projects with five (5) or more units provide at least 15% of the units with deed restrictions to ensure that the units are affordable to very low-income (4%), low-income (4%), and moderate-income (7%) households. Residential projects with nine (9) units or less may pay a per unit fee in-lieu of providing the deed restricted units. Any project with 10 or more units, must construct the deed restricted units.

When considering the potential benefits and impacts of increasing the 15% percent inclusionary requirement, staff considered the following:

Meeting the City's RHNA Obligations. The Council referral makes reference to ensuring that the recommendation "help Alameda meet its RHNA obligations." The City is currently meeting its State RHNA obligations and does not need to increase the 15% Inclusionary Housing requirement to remain in compliance with its RHNA obligations.

The City's RHNA responsibility can be summarized as follows: 1) zone the right amount of land to accommodate the RHNA, 2) do not deny the housing projects proposed on those lands by private sector developers, and 3) do not adopt other regulations that constrain the private developer's ability to build housing on those lands.

Under current state law, the City's RHNA obligation is to provide enough land zoned at the appropriate densities to facilitate the development of the number of units established in the local RHNA. The 2014 Housing Element identifies where that land is in Alameda and how it is zoned appropriately to achieve densities that support housing development for all income groups.

State housing law states that zoning that allows 30 units per acre is sufficient to support housing for all income groups, including the low-income housing identified in the RHNA. In 2012, the City Council established the MF Overlay Zoning District, which allows a density of 30 units per acre. The Alameda Housing Element identifies that the City has enough sites zoned with a MF Overlay to meet the City's low-income portion of the RHNA. For that reason, the State of California has certified that the City is in conformance with State law and is meeting its RHNA obligations.

If the City does not downzone some of its designated Housing Element housing opportunity sites, does not deny a housing project on a Housing Element site, and does not adopt other regulations that might *constrain* the financial feasibility of developing housing, the City will remain in compliance with its RHNA obligations, unless the State adopts new RHNA requirements.

It should also be noted that the State of California considers inclusionary housing ordinances to be *a constraint* on the production of housing in California. For that reason, the State mandates that the City annually evaluate its inclusionary housing ordinance to determine if it is constraining housing development. If the City Council amends the Inclusionary Housing Ordinance, and the changes result in less housing being constructed in Alameda, then the State may determine that the City is out of compliance with its RHNA obligations and state law.

<u>Automatic Density Bonuses</u>. The City Council referral discourages examination of alternatives that would increase the total of number of units permitted on each housing site to increase the amount of affordable housing produced in each project. Therefore, it is important to examine the relationship between the City's inclusionary requirements and the State Density Bonus Law requirements.

The State Legislature enacted the Density Bonus Law (Government Code Sections 65915-65918) to address the shortage of affordable housing in California. The statute recognizes that the market rate units in a project subsidize the affordable units; therefore, the law grants additional market rate units for developers that offer affordable deed-restricted units.

In 2010, in compliance with State law, the City adopted AMC Section 30-17 Affordable Housing Density Bonus Ordinance. Pursuant to the ordinance, if a developer volunteers to provide 5% very low-income, 10% low-income, or 10% moderate-income units, the City must provide the developer with specific density bonuses and waivers from City of Alameda development standards (e.g. height limits, open space requirements, etc.). The percentages are set by State law and cannot be adjusted by local ordinance.

The City's current 15% inclusionary requirement is comprised of requirements for 4% very low-, 4% low- and 7% moderate-income units, which ensures that each project <u>does not</u> automatically qualify for an affordable housing density bonus. When a project triggers a State Density Bonus, the result is that the number of units in the project increases and the actual percentage of affordable units in the project goes down, not up.

Therefore, given the Council's direction to avoid increasing the number of units in each project automatically, the Council:

- Cannot increase the 4% very low requirement without automatically increasing the allowable density on every housing project by 20%
- Cannot increase the 4% low income requirement to more than 9%, without automatically increasing the allowable density on every housing project by 20%.
- Cannot increase the 7% moderate income requirement to more than 9% without automatically increasing the density of every housing project by 5%.

It should also be noted that the automatic density increases would also be accompanies by the opportunity for developers of housing to request waivers from any City zoning requirements, such as height or open space, that limit the project's ability to accommodate the additional density.

<u>Deed-Restricted Unit impacts on the financial feasibility of housing projects.</u> Given California's land and construction costs, the 15% deed-restricted units in each residential project must be financially subsidized by the 85% of the units that are not deed-restricted. (This financial relationship between market rate housing and deed restricted affordable housing is the foundation of the State Density Bonus legislation, which grants market rate bonus units in return for deed restricted affordable units.) The deed-restricted unit subsidies must be covered by either the cost to the buyer or renter of the 85% market rate units, the developer's return on investment, or the price received by the seller of the land. If the subsidies grow to the point where the costs cannot be passed onto to buyer or renter, cannot be absorbed by the developer, or cannot be taken out of the land price, the housing project will become infeasible. If the projects become infeasible, then the inclusionary requirement becomes a constraint on housing construction.

In 2017, housing construction costs have become a major financial burden for housing production in Alameda and the Bay Area. In Alameda, recently approved residential projects, including major planned residential projects such as the Site A project and the Del Monte project are struggling to absorb rapidly increasing construction costs.

Given the rapidly escalating construction costs and the urgency of the current housing crises, staff is becoming increasingly aware of the need to carefully consider the impacts of new regulations on the financial viability of residential development. If increasing the inclusionary requirement results in residential projects becoming financially infeasible, then the decision to increase the inclusionary requirement will not increase the construction of affordable housing; it will decrease the production of affordable housing. If changes to the inclusionary ordinance decrease housing production, those changes could jeopardize the City's ability to stay in compliance with its RHNA obligations because it has adopted an ordinance that constrains housing development.

If increasing the inclusionary requirement can be absorbed by increasing the cost of the market rate units, then the change to the inclusionary ordinance will decrease the ability of each project to provide lower cost, market rate "middle income" units, because the market rate units may need to be designed as larger, more expensive units to help off-set the financial subsidies required to cover the additional deed restricted units.

Inclusionary Housing Requirements in Other Cities. Alameda is not alone in its struggle to address the affordable housing crisis. A brief survey of other cities reveals three general findings:

- Alameda's requirement for 15% inclusionary units that includes very low-, low-, and moderate-income housing exceeds the requirements of most neighboring cities and the few neighboring cities that require more than 15% either do not require low- and very low-income units or allow developers to pay in-lieu fees instead of providing the units.
- Alameda's inclusionary requirement applies equally to ownership and rental projects. Most other cities surveyed have different requirements based on whether or not the housing being built is ownership or rental.
- Alameda is the most restrictive city regarding the options to pay in-lieu fees. In Alameda, only projects with nine or fewer units may pay in-lieu fees. Most other cities allow residential projects to pay fees in-lieu of building the units. Oakland only collects fees.

It also appears that in cities where in-lieu fees are allowed: 1) many developers choose to pay the fee rather than build the units, and 2) those cities tend to receive less density bonus applications, because paying a fee does not qualify a project for a density bonus.

The findings above are based upon a brief review of the following cities:

- Berkeley requires 20% moderate-income units in ownership projects. No very low- or low-income units are required. Rental projects pay an in-lieu fee.
- Emeryville requires 20% moderate-income units in ownership projects. No very low- or low-income units required. Rental projects include 4% very low- and 8% low-, but no moderate-income units.
- Fremont requires 3.5% affordable units (all moderate) on attached units plus a fee. Detached projects include 4.5% affordable units plus a fee.
- Hayward requires 7.5% affordable units (all moderate-income) on attached ownership projects or pay an in-lieu fee. Detached ownership projects provide 10% affordable units or pay an in-lieu fee. No inclusionary housing requirements for rental units.
- San Leandro residential ownership projects include 9% moderate-income units and 6% low-income units. Rental projects include 10% low-income units and 5% very low-income units.
- Union City ownership projects include 13% moderate-income units and 2% very low-income units or pay an in-lieu fee. Rental projects include 10% low-income units and 5% very low-income units or pay an in-lieu fee.
- San Francisco recently adopted an 18% (10% low income and 8% moderate) requirement for rental units and a 20% (12% low income and 8% moderate) for ownership projects. An analysis prepared for the City of San Francisco is attached as Exhibit 2.
- Oakland does not have an inclusionary housing ordinance. Oakland charges an affordable housing fee.

Considerations for requiring middle income units in all residential developments.

The Council asked for recommendations for including “work force” housing requirements for all residential projects. “Work force” housing, is also sometimes called “middle income” housing, or “Affordable by Design” housing. For the purposes of this report, staff uses the term “middle income” housing.

In 2017, a family of four earning $116,900 to $175,320 is a “middle income” family with an income between 120% and 180% of area wide median income (AMI). Based on AMI for Alameda County for a family of four and standard underwriting guidelines, current interest rates and housing costs, households within the workforce income range would be able to afford a home in the $500,000 to $750,000 price range. At approximately $470 per square foot, a $500,000 to $750,000 home will range in size from approximately 1,000 to 1,600 square feet. Increases in AMI will increase the size of a home affordable to a middle income household. Increases in home prices will decrease the size of a home affordable to a middle income household.

In 2017, the City Council adopted a requirement that all new housing in the Main Street neighborhood of Alameda Point include at least ten percent (10%) of the units designed to be affordable to middle income households with a household income between 120% and 180% of area wide median income (AMI). To achieve this requirement, the development application must include information about current and projected home sales prices or rental rates and the proposed unit design and size to justify and explain how at least 10% of the units have been designed to be affordable to the target household income levels.

<u>“Middle Income” Housing is not Deed-Restricted</u>. As described above and in the Main Street Plan, middle income housing is not deed restricted. It utilizes design strategies (“affordable by design”) instead of deed restrictions to create less expensive market rate homes.

The primary way to design a unit to be less expensive is to make it smaller. A 900 square foot unit market rate unit will almost always be less expensive than a 2,000 square foot unit in the same building or project. Another way may be to locate the unit on the back side of a waterfront building without a view of the water. A unit without a waterfront view will almost always be less expensive than the same size unit with a waterfront view in the same building or project. A third way to make a unit less expensive is to provide less amenities or lower quality finishes.

Because it is not deed-restricted and because it is more affordable, a “middle income” household may be able to purchase the unit and over time build equity, which will allow that household to use that equity to purchase a larger home in the future, if the “middle income” unit is too small for the family, or the family has grown over time. In contrast, a purchaser of a deed-restricted unit is limited in the amount of equity s/he can realize and does not fully benefit financially from the Bay Area’s rising housing values. Staff’s assumption is that most “middle income” households do not want to purchase a deed restricted home, because they do wish to build equity that can be used to purchase a bigger home in the future or be used for other financial needs.

<u>10% middle income requirement and financial feasibility.</u> Market rate “middle income” units, which are not deed restricted should not need to be subsidized by the remaining unrestricted market rate units and they should not cause the project financial feasibility issues and questions raised above regarding the potential consequences of increasing the requirements for deed restricted affordable units. However, it should be recognized that requirements that force a percentage of the units to be smaller and less expensive can have a financial impact on a housing

project. If the total number of units allowed on a property is capped by the City, and if the property requires major infrastructure improvements (as many properties in Alameda do), then there are still significant land and improvement costs that must be covered by the market rate units to ensure that the project is financially viable. If land costs and infrastructure costs are fixed for a fixed number of units, then a requirement that a percentage of the units be smaller and less expensive may reduce return on investment. Although the economics on every project are different, it may be assumed that the impact of a middle income, affordable by design requirement will have less financial impact on higher density multifamily developments and a greater financial impact on a lower density single family detached or townhome project, because the land and infrastructure costs for 15 units in a single multifamily building are less per unit than land and infrastructure costs for 15 single family or attached single family homes, which are spread over more land than the 15 units in a single building.

Citywide zoning requirements vs. project by project negotiation. Prior to recommending the 10% requirement for the Alameda Point Main Street neighborhood specific plan, Base Reuse staff and consultants carefully reviewed the financial feasibility and impacts of the 10% requirement on the development potential in the Main Street area. To do this work, staff had the benefit of extensive information about the costs to develop this land, including assumptions about land costs, infrastructure costs, and development costs. (The land is owned by the City, and the City has prepared and priced an extensive Master Infrastructure Improvement Plan for the area.)

City staff does not have similar information about privately held potential housing sites throughout the rest of the City. Therefore, staff has been negotiating middle income, affordable by design requirements on each project individually. The Del Monte project, the Alameda Landing project, the proposed Encinal Terminals project, the proposed Shipways project, and the proposed Alameda Marina project all have "affordable by design" plans or proposals, which were negotiated on a project-by-project basis.

The project-by-project negotiation approach has the benefit of allowing flexibility to require less or more than 10% "middle income" units without jeopardizing the financial viability of the entire project or at the expense of other public benefits, such as additional park lands, transportation services or other public benefits.

A citywide zoning amendment requiring 10% middle income housing has the benefit of eliminating the need for negotiation. Furthermore, establishing a citywide zoning requirement may with time, result in an adjustment of land costs because purchase price offers will with time just down.

Planning Board Recommendations

On July 24, 2017, the Planning Board held a public hearing to consider the City Council's request and the staff's analysis. In summary:

- The Planning Board agreed that affordable housing and the need for more affordable housing is one the top planning issues facing the city. The Planning Board regularly discusses and debates these issues, and the Board played an important role in the recommendations regarding "middle income" housing for the Main Street Neighborhood.

- The Planning Board did not support increasing the 15% inclusionary requirement at this time. As one public speaker stated at the meeting: Alameda is trying to make 25% inclusionary work at Alameda Point, and it is not clear yet that a project with 25% can work financially.

- A number of Board members stated that if the City of Alameda wishes to facilitate more affordable housing, the solution is to raise additional funds for affordable housing through a local bond measure. At least one board member expressed his opposition to any recommendation by the Planning Board supporting a local bond measure for affordable housing. Other Board members also suggested that the Council consider dedicating all of the "boomerang funds" received as the result of the dissolution of redevelopment agencies and the loss of a major local funding source for affordable housing in Alameda.

- Some Board members recommended that the Council re-evaluate the current position stated in the referral that options to increase the total number of units permitted on a site should not be considered. Their point is that if the City allows more housing units on a property, then the project will generate more affordable units without changing the 15% requirement.

- Regarding the middle income housing, the Planning Board did not recommend a 10% citywide requirement for market rate, middle income, affordable by design units. The Board stated that before a citywide requirement is established, the city should do much more research on the financial impacts of a 10% requirement. The research may find that 10% is too low, or if may find that it is too high, but in either case, the City should do the research before establishing a citywide zoning requirement.

<u>Staff Recommendations</u>

Considering the above analysis, the public comments at the Planning Board meeting, and the recommendations of the Planning Board, staff recommends that:

- <u>Deed-Restricted Affordable Housing</u>. The Council is correct in recognizing the severity of the affordable housing crisis; however, at this time construction and land costs are extremely high and further regulations that increase project costs could have a negatively impact financial feasibility and further exacerbate the crisis. In the current economic climate, housing developments in Alameda are struggling to cover the existing costs of development. Any change to increase development costs for housing at this time could be counterproductive and result in a constraint on affordable housing development as opposed to an increase in affordable housing. Therefore, staff does not recommend revising the Inclusionary Housing Ordinance at this time. As part of the Housing Element annual reports, staff and the Council may continue to track effectiveness of the ordinance and consider changes in the future.

- <u>Market Rate Middle Income Housing</u>. The City Council should direct staff to continue to negotiate affordable by design units on a project by project basis and continue to study and examine the financial impacts of a citywide affordable by design requirement to ensure that such a requirement would not result on an additional financial constraint on housing development in Alameda. Based upon the staff's limited experience working with these types of requirements, it appears that different types of projects can absorb different amounts of "middle income" housing. A 10% requirement may be too low for some multifamily projects and too high for lower density single family or townhome developments.

- Financial Resources. The City Council should direct staff to examine options for increasing the City's financial resources for affordable housing.

FINANCIAL IMPACT

Amending the City's Inclusionary Affordable Housing Ordinance and Adding a "Middle Income" Housing Requirement will have no impact on the City's General Fund.

MUNICIPAL CODE/POLICY DOCUMENT CROSS REFERENCE

The Alameda General Plan Housing Element and the Alameda Municipal Code support the development of affordable housing

ENVIRONMENTAL REVIEW

Approval of an annual report is not subject to the review under the California Environmental Quality Act (CEQA), nor is an annual report defined as a "project" under CEQA. No future review is required.

RECOMMENDATION

Hold a Public Hearing and Provide Direction on Recommendations Regarding Amending the City's Inclusionary Affordable Housing Ordinance and Adding a "Middle Income" Housing Requirement.

Respectfully submitted,
Debbie Potter, Community Development Director

By,
Andrew Thomas, Assistant Community Development Director

Exhibits:
1. City Council Referral
2. City of San Francisco Analysis