



Office of the City Manager

PUBLIC HEARING
January 17, 2023

To: Honorable Mayor and Members of the City Council

From: Dee Williams-Ridley, City Manager

Submitted by: Jordan Klein, Director, Planning and Development Department
Lisa Warhuus, Director, Health, Housing and Community Services Department

Subject: Citywide Affordable Housing Requirements

RECOMMENDATION

Conduct a public hearing and upon conclusion:

1. Adopt first reading of an Ordinance amending the Berkeley Municipal Code Chapter 23.328, updating the citywide Affordable Housing Requirements (AHR) in the Zoning Ordinance, repealing existing administration and zoning code sections that refer to affordable housing requirements, BMC Section 22.20.065, and Section 23.312.040(A)(6), and updating references to BMC Chapter 23.328 throughout the Berkeley Municipal Code (**Attachment 1**), to become effective on April 1, 2023.
2. Adopt a Resolution establishing regulations for a voucher program and establishing an in-lieu fee pursuant to BMC Section 23.328.020(A)(2) (**Attachment 2**) upon the effective date of contemporaneously adopted amendments to BMC Section 23.328, and rescind Resolution No. 68,074-N.S. related to fees, exemptions, and administration of inclusionary affordable housing and in-lieu programs upon the effective date of contemporaneously adopted amendments to BMC Section 23.328 (**Attachment 2**).

SUMMARY

The proposed amendments to affordable housing requirements have been developed in response to City Council referrals and State laws that govern affordable housing requirements. In particular, Assembly Bill 1505 in 2017 reauthorized inclusionary housing requirements on rental properties, allowing for the proposed consolidation of most of the City's affordable housing requirements for rental and ownership properties.

Key elements of the proposed amendments include: establishing a new in-lieu fee calculated on a per square foot basis; setting the same per square foot fee for rental and ownership projects; providing new options by which requirements can be met; and various administrative changes. The revised regulations are designed to be easier to understand, make it easier for applicants to comply, simplify administration and

oversight, and increase transparency by consolidating most affordable housing requirements in one place in the municipal code, eliminating conflicting requirements, and standardizing and simplifying certain fees and requirements.

FISCAL IMPACTS OF RECOMMENDATION

The proposed \$45 per square foot in-lieu fee is roughly equivalent to the 2020 Affordable Housing Mitigation Fee (AHMF) of \$39,746 per rental unit. Since 2015, the City of Berkeley has collected approximately \$38 million in Affordable Housing Mitigation Fees towards the Housing Trust Fund Program. It is challenging to predict future affordable housing fee revenue trends given the variables that are outside of the City's control (e.g., how individual project applicants choose to comply with the City's affordable housing requirements, changes in state law, and broader housing market trends). However, if overall housing development and affordable housing compliance plan trends continue, staff projects generating a similar amount over the next eight-year Housing Element cycle.

CURRENT SITUATION AND ITS EFFECTS

The City's affordable housing requirements for new development are currently found in several sections of the Berkeley Municipal Code, including:

- BMC 21.28: Condominiums and Other Common Interest Subdivisions
- BMC 22.20: Mitigations and Fees—Conditions of Approval for Development Projects
- BMC 23.326: Demolition and Dwelling Unit Controls
- BMC 23.328: Inclusionary Housing
- BMC 23.312: Live/Work
- BMC 13.76: Rent Stabilization and Eviction for Good Cause

Prior to 2009, Berkeley had a single Inclusionary Zoning Ordinance (BMC Chapter 23C.12) which applied to both ownership and rental projects. In 2009, a Court of Appeals decision in *Palmer/Sixth Street Properties LP v. City of Los Angeles* (the "Palmer decision") prevented California jurisdictions from enforcing inclusionary housing requirements on rental properties. In response, Berkeley and many other cities adopted an Affordable Housing Mitigation Fee (AHMF). The AHMF ordinance requires payment of a fee and allows the provision of on-site units as an alternative. This approach allowed Berkeley to achieve its policy goals without violating the restrictions imposed by the Palmer decision. Although the provisions of the Inclusionary Housing Ordinance that applied to rental housing remained in the Berkeley Municipal Code, they were unenforceable and superseded by the AHMF ordinance. Inclusionary provisions related to condominiums remained enforceable.

In 2018, the California Legislature passed AB1505 which effectively overturned the Palmer decision and authorized the implementation of inclusionary housing

requirements applied to rental properties, subject to a development feasibility analysis. This legislation has allowed the City to update its programs to combine rental and ownership requirements under a single inclusionary housing ordinance and make other changes that respond to City Council referrals.

The proposed changes are informed by a memorandum prepared by Street Level Advisors, a firm that assists cities across the nation to develop programs and policies to facilitate equitable development, and by feedback provided by the Planning Commission, Housing Advisory Commission and the Council in 2021 (**Attachment 3**).¹ Updating the City's Affordable Housing Requirements is a Strategic Plan Priority Project, advancing our goal to create affordable housing and housing support services for our most vulnerable community members.

Key Elements of Proposed Ordinance and Resolution

1. Consolidation of Affordable Housing Requirements. As authorized by Assembly Bill 1505, the proposed amendments impose "inclusionary" or on-site affordable housing requirements and allow the payment of an in-lieu fee, among other options, instead of the current rules which impose a mitigation fee and allow for the provision of on-site units in-lieu of the fee.^{2, 3} The proposed ordinance consolidates the City's existing regulations by addressing both rental and ownership projects in an amended BMC Chapter 23.328, renamed as "Affordable Housing Requirements," thus allowing for the deletion of the sections of the BMC where these topics were formerly addressed (BMC Sections 22.20.065, and 23.312.A6).

The proposed ordinance would become effective on April 1, 2023. Development projects for which either a Building Permit was issued or a preliminary application was submitted on or before April 1, 2023 shall be subject to this Chapter's requirements that were in place as of the preliminary application's submittal date, but shall otherwise be exempt from this Chapter (see section 23.328.050.F of proposed ordinance). The City's inclusionary requirement remains the same: at least 20% of the residential units of a housing development project must be affordable units, as defined in BMC Section 23.238.

2. Establishment of a Per Square Foot In-Lieu Fee. Instead of the existing method of calculating fees on a per-unit basis, the proposed resolution sets the affordable housing in-lieu fee at \$45 per square foot applied to the gross floor area (as defined by BMC Section 23.106.030) of a housing development project. In a

¹ See Background section for more information on the project methodology and public process.

² Street Level Advisors Memorandum (Jan. 2022): Recommendations 1.1, 1.2, 1.3 (as noted above, condo conversion requirements will be addressed in a separate process in the future), 1.4 and 1.5.

³ Bill Text - AB-1505:

https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201720180AB1505

mixed-use project, the fee shall not be assessed on any leasable commercial floor area (as defined by BMC section 23.106.040), nor on the common areas that exclusively serve non-residential areas uses. For Live/Work units, the In-Lieu Fee shall be applied to the gross floor area that is designated as non-workspace in the zoning permit approvals consistent with BMC Section 23.312.040.⁴

As stated in Section 23.328.030(B), the proposed ordinance also stipulates that the In-Lieu Fee will be estimated as part of the preliminary Affordable Housing Compliance Plan (which is required to be submitted as part of the zoning permit application) and will be finalized prior to building permit issuance (consistent with the final Affordable Housing Compliance Plan). The In-Lieu Fee must be paid prior to Certificate of Occupancy.

The \$45 per square foot fee is roughly equivalent to the 2020 AHMF for projects with typically sized units.⁵ As is the case with the existing AHMF, the proposed In-Lieu Fee would be automatically adjusted every two years based on the California Construction Cost Index (CCCI). Over the last two years, the CCCI has increased sharply, with a cumulative increase of 16.2%, as compared to increases of approximately 2-4% each year between 2016 and 2020. Effective July 1, 2022, the AHMF increased from \$39,746 to \$46,185 per rental unit (see referenced document list at end of this report). This significant increase is reflective of the escalating costs in construction and inflation affecting housing prices throughout the state. Despite the recent increase, City staff are recommending that the City Council set the new per square foot based in-lieu fee based on the fee level of 2020, which was the basis for the financial feasibility analysis prepared by Street Level Advisors.

City staff will be initiating a new feasibility study later this fiscal year, as recommended by both the Planning and Housing Advisory Commissions. This new study will analyze the feasibility of smaller building development types (e.g., “missing middle” housing), monitor the effects of the newly adopted fees and inclusionary requirements, and establish whether adjustments should be made to the fee level or cost structure. There may be reasons to raise or lower the per square foot fee: to adjust the sliding scale for smaller projects, better align the developer cost of the inclusionary versus fee options, or to make other changes to reflect market conditions as the city emerges from the pandemic and faces inflationary, recessionary, and other market influences.

3. Incentive to Increase Affordable Units Serving Extremely Low-Income (ELI) Households (up to 30% of AMI). The City’s current rules require that 40% of all Very Low Income (VLI; up to 50% of AMI) units be offered first to Housing Choice

⁴ See definitions for “Floor Area, Gross” and “Floor Area, Leasable (BMC 23.106.030, under “F”) and draft ordinance (Attachment 1) for “Housing Development Project” (section 23.328.020).

⁵ SLA Jan. 2022 Memo, Recommendations 2.1 and 3.1.

voucher holders, and 40% be offered first to Shelter+Care voucher holders. The proposed changes would require that all of the required VLI units be offered to voucher holders (50% to Housing Choice voucher holders and 50% to Shelter+Care voucher holders) before being marketed to other income-eligible households. This change, along with the way that the City's requirements interact with the State Density Bonus, will serve to slightly increase the share of ELI tenants served, without adding layers of complexity to the program, since voucher holders in both programs generally have incomes well below 30% AMI.⁶

4. Standardization of Ownership and Rental Fees. The feasibility analysis prepared by Street Level Advisors found that the City's existing requirements for ownership/condominium projects resulted in an equivalent per square foot fee ranging from \$54 to \$75, which is considerably higher than the equivalent per square foot fees estimated for rental projects (\$45 per square foot). The imposition of a higher fee discourages development of new home ownership projects. Setting the fee at \$45 per square foot for both rental and ownership projects would "level the playing field" and still generate substantial in-lieu fees per unit, since ownership units tend to be larger than rental units. The proposed ordinance authorizes the City Council to set fees, and the proposed resolution sets the affordable housing in-lieu fee at \$45 per gross residential square foot for both rental and ownership projects. This approach will be revisited as part of the new feasibility study.⁷

5. Standardization of Live-Work Requirements. The proposed ordinance consolidates the affordable housing requirements for live/work units from BMC 23.312 into BMC 23.328, and removes the exemption from inclusionary and fee requirements for live/work projects. The same requirements would apply to live/work projects as any other project. Live/work projects would also retain the existing marketing provision, to proactively ensure that the developer reaches out to income-eligible persons performing a work activity appropriate to the unit and district where the property is located.⁸

6. Land Dedication Option. The proposed ordinance adds an option for project applicants to dedicate land, if authorized by the City Manager, for an approved non-profit housing developer (see proposed ordinance Section 23.328.030.C). Donated land must meet specified criteria to ensure that the land is suitable for development of affordable housing, including having appropriate infrastructure, an absence of hazardous materials or other hazards, and be of equal or greater in value than the in-lieu fee that otherwise would be required.⁹

⁶ See SLA Recommendation 4.1.

⁷ See SLA Recommendation 6.1.

⁸ SLA Jan. 2022 Memo: Recommendations 7.1.

⁹ SLA Jan. 2022 Memo: Recommendation 8.1.

7. Family-Sized Units Option. During the process of developing the recommendations, policymakers expressed interest in promoting the development of affordable units that are suitable for families, but actively discourage units with high bedroom counts. The draft ordinance adds an option for project applicants to propose an alternative mix of affordable unit types whose total size is at least 20% of the residential Gross Floor Area (rather than a unit-for-unit equivalent), in order to achieve a mix of affordable units including two- and three-bedroom units. Review and approval of the proposal would be at the discretion of the City Manager or their designee.¹⁰ This option has been further revised from earlier proposals, which would have provided a similar option by right if a project applicant provided affordable units including a specified level of two-or three-bedroom units. The current option better addresses staff implementation concerns by establishing a process by which a proposal can be reviewed holistically to ensure that unit size, unit mix and overall number of units provided and households served meet the intent of the ordinance.

8. Removal of Exemption for Most Group Living Accommodation (GLA) Projects. The proposed ordinance would remove the current exemption for GLAs from inclusionary and fee requirements. Fraternities, sororities and other specially designated units recognized by the University of California would retain their exemption. The proposed ordinance would also prohibit affordable units from having more than three bedrooms in order to reduce administrative burdens.¹¹

9. Eliminate Exemption for Small Projects and Establish Tiered Fees. The proposed resolution eliminates the exemption for projects of one to four units and replaces it with a tiered fee for projects with less than 12,000 square feet in residential Gross Floor Area (BMC 23.106.030), by reducing the fee by \$2 per square foot for each 1,000 square foot increment less than 12,000 sf (see Table 1 below and Attachment 2).¹²

The proposed fee structure is intended to address concerns expressed about the potential for developers to segment their projects into smaller projects of four units or less in order to circumvent existing rules, while also reducing the fee for smaller projects. The threshold of 12,000 square feet (roughly equivalent to 12 to 15 units) to start the phased reduction provides a relatively long phase-in of the full fee with small increments, to remove incentives for applicants to intentionally size projects just below the level of the next fee amount step.

¹⁰ SLA Jan. 2022 Memo: Recommendation 9.1.

¹¹ SLA Jan. 2022 Memo: Recommendations 11.1 and 11.2.

¹² SLA Jan. 2022 Memo: Recommendations 12.1 and 12.2.

Table 1. Proposed Tiered Square Foot Based Fee

Applicable Gross Floor Area (BMC 23.328.030(B))	Fee per Square Foot
12,000+	\$45
11,000-11,999	\$43
10,000-10,999	\$41
9,000-9,999	\$39
8,000-8,999	\$37
7,000-7,999	\$35
6,000-6,999	\$33
5,000-5,999	\$31
4,000-4,999	\$29
3,000-3,999	\$27
2,000-2,999	\$25
1,000-1,999	\$23
<1,000	\$21

11. Cap Annual Rate of Rent Increases.¹³ As recommended by the Housing Advisory Commission (HAC), the proposed ordinance stipulates that any percentage increase in rent of an affordable unit shall be the lesser of 65% of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) in the San Francisco-Oakland-San Jose region (as reported and published by the U.S. Department of Labor, Bureau of Labor Statistics for the twelve-month period ending the previous December 31), or 65% of the corresponding increase in AMI for the same calendar year. In no event, however, shall the allowable annual adjustment be less than zero (0%) or greater than seven percent (7%). This is consistent with how the Rent Stabilization Board calculates rent increases, but is a change from the existing affordable housing requirements, which tie rent increases to the increase in Area Median Income (AMI) only. When the affordable units are vacant and re-rented, the property owner can increase the rent based on the affordability category of the unit.

The Planning Commission recommended that rent increases be tied to AMI two years after adoption of ordinance. Staff do not recommend this approach because annual rent adjustments are typically smaller and therefore more manageable for tenants. Increasing rents based on AMI after two years may create a larger rent increase that is more difficult for tenants to predict/budget. This is reflective of staff experience managing properties that have “banked” increases in the past and implement multiple year increases at once.

The goal is to ensure that rent increases do not result in a high housing cost burden or displacement of existing tenants. Over the past decade, annual increases in AMI are generally higher than the average increase in income of lower income

¹³ SLA Jan. 2022 Memo: Recommendation 13.

households, resulting in unintended adverse impacts to tenants. Although CPI-U has traditionally been more stable than AMI, this may change given the current inflationary cycle. Staff recommend tying rent increases to the lesser of annual increases in CPI-U or AMI.

12. Administrative Changes. The proposed ordinance also recommends four administrative changes:¹⁴

- a. Affordable Housing Compliance Plan. The proposed ordinance language was clarified to better define the enforceable agreement (the “Affordable Housing Compliance Plan”) that applicants are required to submit and when such a plan must be submitted to the City. The Compliance Plan must specify how an applicant will comply with City affordable housing requirements, including the number and type of affordable units, the amount of In-Lieu Fees, and/or the parcels of land (or portions thereof) that will be provided and/or paid, and must be submitted to the Zoning Officer at the time of application.
- b. Authorization of administrative citations. The proposed ordinance explicitly authorizes the creation of a proposed schedule of fines for monitoring and compliance violations to be included in the program guidelines.
- c. Deduction of required fees/costs from gross rent. The proposed ordinance requires that any mandatory fees imposed by the property-owner as a condition of tenancy, as well as an allowance for tenant-paid utilities, be included in the determination of whether a unit is affordable to Very Low-Income or Low-Income Households.
- d. Increase administrative set-aside from 10% to 15%. The proposed ordinance states that 15% of In-Lieu Fees collected may be used to pay for administration of the In-Lieu Fee or the Housing Trust Fund program, due to the increasing size and complexity of the City’s portfolio of HTF units. This also allows staff to better budget for administrative expenses given the unpredictable nature of market-based fee revenue. At least 85% of In-Lieu Fees collected shall be deposited into the City’s Housing Trust Fund program.

Other Policy Considerations

Staff are also advancing proposed changes to the City’s regulation of demolitions (BMC Chapter 23.326). Demolition requirements help protect existing rental-controlled housing by regulating and compensating for the elimination of such units which occurs through modifications to existing housing stock (e.g., removing kitchens, combining units). The modifications currently under consideration retain, modify and expand existing requirements for the replacement of protected units and the provision of relocation benefits for displaced tenants, while bringing the local ordinance into better alignment with recent updates to state law. Staff anticipate bringing revisions to the

¹⁴ SLA Jan. 2022 Memo: Recommendation 14.1 - 14.4.

demolition requirements to City Council in early 2023, subsequent to additional review by the 4x4 Committee and Planning Commission.

In addition, a number of proposed changes to the City's condominium conversion regulations were presented in the memorandum prepared by Street Level Advisors. These included simplifying the calculation of the required fee, reducing the fees under certain circumstances and allowing flexibility in the use of the fees. These recommendations require additional consideration and may require additional nexus and feasibility analyses. Changes to BMC Chapter 21.28, Condominiums and Other Common Interest Subdivisions, will be considered in a future, separate item.

BACKGROUND

The City of Berkeley has a strong history of programs and initiatives to retain existing affordable and rent controlled tenant housing, protect tenants from displacement, and create new affordable housing, including deed-restricted income-qualified housing. City Council has adopted multiple, interrelated referrals to explore revisions to the City's affordable housing requirements for new development that are currently codified in several sections of the Berkeley Municipal Code (**Attachment 4**).

There have also been changes to State laws that govern affordable housing requirements, streamlining, dwelling unit replacement, and density bonus incentives. There are also numerous locally adopted implementing resolutions that set fee amounts and exemptions. In addition, the City has administrative guidelines and practices to implement the State and local requirements.

The City engaged the consulting firm Street Level Advisors to evaluate existing regulations and potential changes in order to comprehensively update the City's affordable housing requirements. The work to date has included:

- **October 2020:** Street Level Advisors presented a range of identified policy issues and solicited feedback from the public and stakeholders including affordable housing developers and advocates, market-rate developers, Planning Commission, Housing Advisory Commission, Zoning Adjustments Board, and Rent Stabilization Board.
- **May 2021:** Street Level Advisors prepared a memorandum analyzing 14 categories of potential changes to the City's affordable housing requirements based on Council referrals and stakeholder and public feedback. Staff and Street Level Advisors presented the proposed changes to the Planning Commission and at a City Council worksession to inform drafting of the ordinance and resolution.¹⁵

¹⁵ May 18, 2021 Council Worksession Report: <https://berkeleyca.gov/sites/default/files/documents/2021-05-18%20WS%20Item%2002%20Updating%20Citywide%20Affordable.pdf>

- **March 2022:** Staff presented the proposed resolution and ordinance to the Planning Commission and the Housing Advisory Commission and requested a recommendation to bring to the City Council.

Both Commissions approved the staff recommendations with a few modifications, including the following recommendations:

- **Update feasibility analysis.** Both Commissions recommended new evaluations of the in-lieu fee within one to two years (HAC and PC, respectively), including tracking distribution of fees, on-site units, mixed compliance projects, small project and ownership projects, including co-housing/community housing. As noted above, staff will be initiating a new feasibility study later this fiscal year.
- **Cap annual rent increases for inclusionary units.** The Planning Commission recommended that rent increases should be tied to Area Median Income after two years of ordinance adoption. The Housing Advisory Commission (HAC) recommended that rent increases should be tied to 65% of Consumer Price Index (CPI), which is consistent with the manner in which the Rent Stabilization Board calculates rent increases. The proposed ordinance was revised to tie rent increases to 65% of CPI.
- **Ensure definitions of terms are included in the chapter and/or in the zoning ordinance glossary.** As recommended by the Planning Commission, the proposed draft ordinance and the draft resolution have been revised for clarity. Staff have revised the drafts to include definitions and clearer references regarding how the proposed in-lieu fee would be applied and calculated.
- **Require Very Low-Income units to be first offered to voucher holders.** The Planning Commission recommended that the existing regulations remain in place such that 80% of Very Low-Income units be required to be offered to voucher holders (40% to Shelter+Care and 40% to Section 8 voucher holders) instead of proposed ordinance increase to 100% (50% to Shelter+Care and 50% to Section 8 voucher holders). The HAC agreed with the draft ordinance as proposed by staff.

ENVIRONMENTAL SUSTAINABILITY AND CLIMATE IMPACTS

Infill affordable housing may reduce greenhouse gas emissions when located near transit, job centers, and other amenities. The proposed changes are intended to continue to facilitate on-site affordable housing units and fees available to the Housing Trust Fund for affordable housing developers in order to support the provision of affordable housing and housing support services for our City's most vulnerable community members.

RATIONALE FOR RECOMMENDATION

The recommended changes are primarily in response to policy referrals from City Council related to affordable housing development. The new ordinance is intended to maintain or increase the number of on-site affordable housing units and the amount of

fees available to the Housing Trust Fund, while addressing a number of other policy considerations and concerns regarding the complexity of existing regulations, and maintaining the overall feasibility of housing development in Berkeley.

ALTERNATIVES CONSIDERED

The Planning Commission and Housing Advisory Commission each discussed the merits of setting the fee at a level either higher or lower than the recommended \$45 per square foot.

Staff considered raising the proposed per square foot in-lieu fee by 16.2% to match the recent automatic adjustment to the existing Affordable Housing Mitigation Fee on July 1, 2022, which would be equivalent to \$52 per square foot. Street Level Advisors recommended considering adjustments to the fee once the housing market had stabilized following the fluctuations that resulted from the pandemic, and to concurrently conduct an updated feasibility analysis within the next three years to determine what fee level typical projects could support. Given the recent increase in construction costs and inflation overall, it seems prudent to base further increases in fees on updated feasibility analyses prior to adjusting the level of the fee.

Staff also considered a modified tiered fee structure that would provide a fee discount to any project with fewer than 8,000 square feet (roughly equivalent to 8-10 units) and phase in the fee more quickly in \$3 increments, as shown in Table 2 below. Reductions below 8,000 square feet could eliminate the value of phasing in the \$45 square foot fee versus charging a lower fee for smaller projects.

Table 2. Modified Tiered Square Foot Based Fee

Applicable Gross Floor Area (BMC 23.328.030(B))	Fee per Square Foot
8,000+	\$45
7,000-7,999	\$42
6,000-6,999	\$39
5,000-5,999	\$36
4,000-4,999	\$33
3,000-3,999	\$30
2,000-2,999	\$27
1,000-1,999	\$24
<1,000	\$21

Some Planning Commission members expressed concerns regarding the removal of the exemption of one- to four-unit projects prior to completing a feasibility analysis on these types of projects. The City Council could consider modifying the effective date of

the tiered fee structure and/or the exemption of small projects for a specified period of time by which the new feasibility study will likely have been completed (e.g. 18 – 24 months). The City Council could also consider maintaining the existing exemption for one- to four-unit projects and/or not adopt the tiered fee structure.

Staff also considered introducing a limited local density bonus program for small projects and Group Living Accommodations (where individuals generally lease bedrooms and not apartments). The program would prohibit the provision of on-site affordable units in these types of projects, and allow additional development as would be allowed under the State Density Bonus in exchange for payment of a fee (instead of on-site units). After further review and consideration, staff have concluded that the proposed tiered fee for small projects (less than 12,000 sf), and the definition of affordable units being limited to three bedrooms or less, serve to address the goal of incentivizing smaller projects to select the in-lieu fee option.

The Council could also consider no changes to the current structure of having an Affordable Housing Mitigation Fee and an in-lieu inclusionary requirement.

CONTACT PERSON

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Attachments:

- 1: Draft Ordinance
- 2: Draft Resolution
- 3: Updating Affordable Housing Requirements for the City of Berkeley: Analysis and Recommendations. Prepared by Street Level Advisors, Revised February 2022.
- 4: Summary of Council Referrals Related to Affordable Housing Requirements
- 5: Public Hearing Notice

Links to Referenced Documents:

- 1: Off-Agenda Memo Regarding Bi-annual Increase to Affordable Housing Mitigation Fee, July 13, 2022:
https://berkeleyca.gov/sites/default/files/documents/Affordable%20Housing%20Mitigation%20Fee%20Increase%20071322_0.pdf
- 2: City Council Worksession Report: Citywide Affordable Housing Requirements Update, May 18, 2021:
<https://berkeleyca.gov/sites/default/files/documents/2021-05-18%20WS%20Item%2002%20Updating%20Citywide%20Affordable.pdf>
- 3: Planning Commission Report: Citywide Affordable Housing Requirements Update, May 5, 2021:

<https://berkeleyca.gov/sites/default/files/legislative-body-meeting-agendas/2022-03-02%20PC%20Agenda%20Packet.pdf>

ORDINANCE NO. -N.S.

AFFORDABLE HOUSING REQUIREMENTS; AMENDING BERKELEY MUNICIPAL
CODE TITLES 22 AND 23

BE IT ORDAINED by the Council of the City of Berkeley as follows:

Section 1. That Berkeley Municipal Code Section 22.20.065, and Section 23.312.040(A)(6) are hereby repealed.

Section 2. That Berkeley Municipal Code Chapter 23.328 is repealed and re-enacted to read as follows:

23.328.010 Findings and Purpose.

A. The State of California has established a Regional Housing Needs Allocation (RHNA) process under which it allocates a “fair share” of the regional housing need, updated periodically, to each local jurisdiction. The “fair share” allocated to Berkeley increased significantly based on the regional housing needs determination finalized in late 2021. The sixth cycle of the RHNA for the San Francisco Bay Area allocates to Berkeley a “fair share” that calls for adequate sites for 8,934 housing units for the period from 2023 to 2031, including sites for 2,446 Very Low-Income units, 1,408 Low Income units, and 1,416 Moderate Income units. Under the state Housing Element Law, the City must update its Housing Element to provide adequate sites for its updated “fair share” allocation by 2023.

B. The Bay Area suffers from a shortage of affordable housing. As the Bay Area region experiences increased economic growth and a high demand for housing, housing prices continue to rise, which leads to displacement of low income residents and exacerbates the shelter crisis that has led to unacceptably high rates of homelessness in the City of Berkeley and the Bay Area region.

C. In 1990, the City established the Housing Trust Fund program to pool available funding for affordable housing development. The Housing Trust Fund program is funded

by federal, state, and local revenues, including by in-lieu and mitigation fees paid by developers of market-rate housing projects under the City's existing affordable housing ordinances.

D. The City Council hereby finds that there is a legitimate public interest in the provision of affordable housing to address the crises of displacement, homelessness, and lack of housing affordability in the City, and that there is a significant and increasing need for affordable housing in the City to meet the City's regional share of housing needs under the California Housing Element Law.

E. The City Council further finds that the public interest would best be served if new affordable housing were integrated into new market-rate residential developments to facilitate economically diverse housing, while also providing alternative options to the on-site construction of affordable housing such as the payment of fees to replenish the City's Housing Trust Fund program and allowing for the construction of affordable housing on land dedicated by market-rate housing developers.

F. The City Council intends that this Ordinance be construed as an amendment to the City's existing affordability requirements, and that the repeal and re-enactment of any requirement shall not be construed to relieve a party of any outstanding obligation to comply with the requirements applicable to any previously approved Housing Development Project.

23.328.020 Definitions.

A. "Affordable Unit" means a Residential Unit that is in perpetuity affordable to Very Low Income Households or Lower-Income Households, as defined in California Health and Safety Code sections 50052.5 and 50053.

B. "Affordable Housing Compliance Plan" means an enforceable commitment by an Applicant to comply with the requirements of this Chapter that identifies the number and type of Affordable Units, the amount of In-Lieu Fees, and/or the parcels of land (or portions thereof) that will be provided and/or paid by the Applicant to comply with those requirements.

C. "AMI" means the area median income applicable to the City of Berkeley, as defined by the U.S. Department of Housing and Urban Development, or its successor provision, or as established by the City of Berkeley in the event that such median income figures are no longer published by the U.S. Department of Housing and Urban Development.

D. "Applicant" means any individual, person, firm, partnership, association, joint venture, corporation, entity, combination of entities or authorized representative thereof, who applies to the City for any Housing Development Project.

E. "Housing Development Project" means a development project, including a Mixed-Use Residential project (as defined in 23.502.020(M)(13), involving the new construction of at least one Residential Unit. Projects with one or more buildings shall be considered as a sole Housing Development Project and not as individual buildings.

F. "Housing Trust Fund" means the program to finance low and moderate-income housing established by Resolution No. 55,504-N.S., or any successor fund established for the same purpose.

G. "Lower-Income Household" means a household whose income does not exceed the low-income limits applicable to Alameda County, as defined in California Health and Safety Code section 50079.5 and published annually pursuant to Title 25 of the California Code of Regulations, Section 6932 (or its successor provision) by the California Department of Housing and Community Development.

H. "Regulatory Agreement and Declaration of Restrictive Covenants" means, for the purposes of this Chapter, a legally binding agreement recorded against the property to codify the requirements and conditions of a Housing Development Project providing Affordable Units.

I. "Residential Unit" means, for purposes of this Chapter, any Dwelling Unit, any Live/Work Unit, or any bedroom of a Group Living Accommodation (GLA) except a GLA in a University-recognized fraternity, sorority or co-op; provided, however, that for purposes of this Chapter, "Residential Unit" shall not include any Accessory Dwelling Unit or Junior Accessory Dwelling Unit.

J. "Very Low-Income Household" means a household whose income is no more than 50% of AMI, as defined in California Health and Safety Code section 50105.

23.328.030 Affordable Housing Requirements.

A. Requirement to Construct Affordable Units

1. Except as otherwise provided in this Chapter, no permit for the construction of any Housing Development Project shall be issued unless at least 20% of the Residential Units are Affordable Units. When the calculation results in a fractional unit, an Applicant will round up to the nearest whole unit. The Affordable Units shall have the same proportion of unit types (i.e., number of bedrooms) and average size as the market rate units (provided, however, that no Affordable Unit may have more than three bedrooms).

2. In lieu of providing Affordable Units pursuant to Paragraph 1, an Applicant may propose an alternative mix of unit-types to comply with this Chapter by providing Affordable Units that comprise at least 20% of the applicable "Floor Area, Gross" of the Housing Development Project as defined in section 23.328.030(B)(2) in order to achieve a mix of Affordable Units including two-bedroom or three-bedroom units. The City Manager or their designee may approve the proposed alternative mix of unit- types that meet the requirements of this section.

3. Affordable Units shall be (a) reasonably dispersed throughout the Housing Development Project; and (b) comparable to other Residential Units in the Housing Development Project in terms of appearance, materials, and finish quality. Residents of Affordable Units shall have access to the same common areas and amenities that are available to residents of other Residential Units in the Housing Development Project.

4. The City Manager or their designee shall adopt rules and regulations (a) establishing the affordable sales price or affordable rent for each Affordable Unit, consistent with the requirements of Health and Safety Code sections 50052.5

and 50053; and (b) ensuring that Affordable Units are sold or rented to Very Low Income and Lower Income Households, consistent with the requirements of this Chapter.

5. Rental Units.

a. At least 50% of the required Affordable Units in the Housing Development Project shall be offered at a rent that is affordable to Very Low-Income Households, up to a maximum requirement of 10% of the total units in the Housing Development Project if the project provides more Affordable Units than are otherwise required by this Chapter.

b. In determining whether a unit is affordable to Very Low Income or Low Income Households, maximum allowable rent for any affordable unit shall be reduced by an amount equal to the value of the City-published utility allowance provided for Tenant-paid utilities and any other mandatory fee imposed by the property owner as a condition of tenancy.

c. Any percentage increase in rent of an occupied Affordable Unit shall not exceed the lesser of 65% of the increase in the Consumer Price Index for All Urban Consumers (CPI-U) in the San Francisco-Oakland-San Jose region as reported and published by the U.S. Department of Labor, Bureau of Labor Statistics, for the twelve-month period ending the previous December 31, or 65% of the percentage increase in AMI for the same calendar year. In no event, however, shall the allowable annual adjustment be less than zero (0%) or greater than seven percent (7%).

d. Affordable Units designated for Very Low Income Households shall be offered for rent to tenants receiving assistance under the Section 8 Program (42 U.S.C. Section 1437f), the Shelter Plus Care Program (42 U.S.C. Section 11403 *et. seq.*), or any similar state or federally funded rent subsidy program prior to being offered to other potential tenants. The Council may establish related program requirements by resolution.

e. The owner of any Affordable Unit offered for rent must report to the

City annually the occupancy and rents charged for each Affordable Unit, and any other information required pursuant to rules and regulations adopted by the City Manager or their designee.

6. Ownership Units. Inclusionary units in ownership projects shall be sold at a price that is affordable to an appropriate-sized household whose income is no more than 80 percent of the AMI.

7. All Affordable Units shall be subject to a recorded affordability restriction requiring in perpetuity that each Affordable Unit be sold at an affordable sales price or offered for rent at an affordable rent, as defined in this Chapter.

8. Affordable Live/Work Units shall be proactively marketed by the Applicant and/or owner to income-eligible persons performing a work activity permitted in the district where the project is located whose type of work causes them to have a requirement for a space larger in size than typically found in residential units.

9. An Affordable Unit that is constructed to qualify for a density bonus under Government Code section 65915 that otherwise meets the requirements of this Chapter shall qualify as an Affordable Unit under this Chapter.

B. Option to Pay In-Lieu Fee

1. In lieu of providing some or all of the Affordable Units required under this Chapter (including any fractional units), an Applicant may elect to pay a fee, the amount of which the City Council may establish by resolution ("In-Lieu Fee"). The City Council may by resolution differentiate among types, classes, and locations of Housing Development Projects to the extent permitted by law; may establish separate fees and criteria for the provision of units that are affordable to Very Low Income Households and units that are affordable to Low Income Households; and may establish the method for calculation of the In-Lieu Fee.

2. In-Lieu Fees shall be applied to the "Floor Area, Gross" (as defined by BMC Section 23.106.030) of a Housing Development Project. However, in a mixed-use project, the fee shall not be assessed on any "Floor Area, Leasable"

(as defined by BMC section 23.106.040), nor on any common areas that exclusively serve a non-residential use. For Live/Work units, the In-Lieu Fee shall be applied to the "Floor Area, Gross" that is designated as non-workspace in the zoning permit approvals consistent with BMC section 23.312.040.

3. In-Lieu Fees shall be estimated as part of the preliminary Affordable Housing Compliance Plan and finalized at the time of building permit issuance, consistent with the final Affordable Housing Compliance Plan.

4. In-Lieu Fees shall be paid prior to the issuance of the first Certificate of Occupancy, or if no Certificate of Occupancy is required, prior to the initial occupancy of the Housing Development Project.

5. Up to 15% of In-Lieu Fees collected may be used to pay for administration of the In-Lieu Fee or the Housing Trust Fund program. At least 85% of In-Lieu Fees collected shall be deposited into the City's Housing Trust Fund program.

C. Option to Dedicate Land

1. At the discretion of the City Manager or their designee, the requirements of this Chapter may be satisfied by the dedication of land in lieu of constructing Affordable Units within the Housing Development Project if the City Manager or their designee determines that all of the following criteria have been met:

a. Marketable title to the site is transferred to the City, or an affordable housing developer approved by the City, prior to issuance of building permit of the Housing Development Project pursuant to an agreement between the Applicant and the City.

b. The site has a General Plan designation that authorizes residential uses and is zoned for residential development at a density to accommodate at least the number of Affordable Units that would otherwise be required under Paragraph A.

c. The site is suitable for development of the Affordable Units, taking into consideration its configuration, physical characteristics, location, access, adjacent uses, and applicable development standards and other relevant planning and development criteria including, but not limited to, factors such as the cost of construction or development arising from the nature, condition, or location of the site.

d. Infrastructure to serve the dedicated site, including, but not limited to, streets and public utilities, are available at the property line and have adequate capacity to serve the maximum allowable residential density permitted under zoning regulations.

e. The site has been evaluated for the presence of hazardous materials and for the presence of geological hazards and all such hazards are or will be mitigated to the satisfaction of the City prior to acceptance of the site by the City.

f. The value of the site upon the date of dedication is equal to or greater than the in-lieu fee that would otherwise be required under Paragraph A. The value of the site shall be determined pursuant to the program guidelines approved by the City Manager or their designee.

2. The City shall solicit proposals from affordable housing developers to construct restricted income units on the site dedicated to the City, but if the City is unable to obtain a qualified affordable housing developer to construct a viable affordable housing development on the property within two years of its solicitation or to commence construction within five years, the City may sell, transfer, lease, or otherwise dispose of the dedicated site for any purpose. Any funds collected as the result of a sale, transfer, lease, or other disposition of sites dedicated to the City shall be deposited into a fund designated for use in the City's Housing Trust Fund program.

23.328.040 Waiver or Modification of Affordable Housing Requirements.

A. The City Manager or their designee may waive or modify up to fifty percent of the requirements of this Chapter at their sole discretion where any of the following conditions are established:

1. A project providing low- or moderate-income housing is funded in whole or in part by the City's Housing Trust Fund program;
2. The implementation of the requirements of this Chapter would violate the rights of any person under the California or United States Constitutions, any federal law, or any state law governing a matter of statewide concern and applicable to a charter city; or
3. The benefits of the project to the City outweigh the detriment of foregoing the provision of Affordable Housing or the contribution of In-Lieu fees to the Housing Trust Fund program. In weighing the benefits and detriment to the City, the following factors may be considered:
 - a. The impact of the requirements of this Chapter on the feasibility of a Housing Development Project;
 - b. Other economically beneficial uses of the Applicant's property;
 - c. The burdens the Housing Development Project places on the City in terms of increased demand for affordable housing, childcare, public facilities or amenities, or other impacts which reasonably may be anticipated to be generated by or attributable to the Housing Development Project; and
 - d. The impact on the Housing Trust Fund program of foregoing the payment of any In-Lieu fee that would otherwise be made.

B. Waivers or modifications greater than fifty percent of the amount which otherwise would be required by this Chapter shall be subject to the approval of City Council.

C. The Applicant shall bear the burden of proof to establish eligibility for a waiver or modification of the requirements of this Chapter.

23.328.050 Implementation.

A. The Applicant for any Use Permit or Zoning Certificate for a Housing Development Project shall submit a preliminary Affordable Housing Compliance Plan to the Zoning Officer at the time of application. The preliminary Affordable Housing Compliance Plan shall be incorporated as a condition of approval of any Use Permit or Zoning Certificate issued to the Applicant. No building permit may be issued for the project until the final Affordable Housing Compliance Plan is approved.

B. The Applicant must execute a Regulatory Agreement and Declaration of Restrictive Covenants to regulate all Affordable Units provided in a Housing Development Project. No building permit may be issued for the project until the Regulatory Agreement and Declaration of Restrictive Covenants are executed.

C. The Affordable Housing Compliance Plan and/or Regulatory Agreement and Declaration of Restrictive Covenants may be amended administratively, provided that the Zoning Officer finds them to be in full compliance with the provisions of this ordinance and State law, prior to issuance of Certificate of Occupancy.

D. The City Manager or their designee may promulgate additional rules and regulations consistent with the requirements of this Chapter.

E. The City Council may by resolution establish fees for the implementation and administration of this Chapter and may establish administrative penalties for violations of this Chapter.

F. Exemptions.

1. A Housing Development Project for which either a building permit was issued on or before April 1, 2023 or a preliminary application including all of the information required by subdivision (a) of California Government Code section 65941.1 was submitted on or before April 1, 2023 shall be subject to this

Chapter's requirements that were in place as of the preliminary application's submittal date but shall otherwise be exempt from this Chapter. This exemption shall expire upon the occurrence of any of the circumstances defined in paragraphs (2), (6), or (7) of subdivision (o) of California Government Code section 65589.5 or in subdivision (d) of California Government Code section 65941.

2. A Residential Unit that replaces a unit existing as of April 1, 2023 that has been destroyed by fire, earthquake or other disaster, or that was previously subject to a mitigation fee or inclusionary housing requirement.
3. A Residential Unit existing as of April 1, 2023 that is expanded, renovated, or rehabilitated.

Section 3. The Berkeley Municipal Code Section 23.330.070 is hereby amended to read as follows:

23.330.070 Qualifying Units.

Qualifying units must meet the standards set forth in ~~Section 23.328.040 (Requirements Applicable to All Inclusionary Units)~~ Chapter 23.328 (Affordable Housing Requirements).

Section 4. Copies of this Ordinance shall be posted for two days prior to adoption in the display case located near the walkway in front of the Maudelle Shirek Building, 2134 Martin Luther King Jr. Way. Within 15 days of adoption, copies of this Ordinance shall be filed at each branch of the Berkeley Public Library and the title shall be published in a newspaper of general circulation.

RESOLUTION NO. _____

ADOPTING REGULATIONS FOR VOUCHER PROGRAM AND ESTABLISHING AN IN-LIEU FEE TO SUPPORT THE PROVISION OF AFFORDABLE HOUSING PURSUANT TO BERKELEY MUNICIPAL CODE SECTION 23C.12.030.B, AND RESCINDING RESOLUTION 65,074-N.S.

WHEREAS, Berkeley Municipal Code (“BMC”) Section 23.328 establishes a requirement that 20% of Residential Units (as defined) in market-rate developments be offered for rent or sale at affordable rents or prices, as defined (“Affordable Units”); and

WHEREAS, BMC Section 23.328 authorizes the City Council to establish by resolution preferences for renting Affordable Units offered for rent to tenants receiving assistance under the Section 8 Program (42 U.S.C. Section 1437f), the Shelter Plus Care Program (42 U.S.C. Section 11403 *et. seq.*), or similar state or federally funded rent subsidy programs; and

WHEREAS, BMC Section 23.328 authorizes developers of market-rate housing to pay a fee in lieu of complying with the requirement to provide on-site affordable housing (“In-Lieu Fee”); and

WHEREAS, BMC Section 23.328 authorizes the City Council to establish the In-Lieu Fee by resolution, and further authorizes the Council to differentiate among types, classes, and locations of Housing Development Projects to the extent permitted by law; to establish separate fees and criteria for the provision of units that are affordable to Very Low Income Households and units that are affordable to Low Income Households; and to establish the method for calculating the In-Lieu Fee; and

WHEREAS, the City retained Street Level Advisors to provide analysis and recommendations for updating the City’s affordable housing requirements, the scope of which included a financial feasibility study of the City’s affordable housing mitigation fees; and

WHEREAS, Street Level Advisors prepared a Financial Feasibility Analysis dated April 27, 2021, which determined that an In-Lieu Fee of \$45 per square foot of the residential Gross Floor Area (as defined in BMC 23.106.030) would be financially feasible; and

WHEREAS, Street Level Advisors recommended certain modifications to the \$45 per square foot affordable housing fee that would not adversely impact the financial feasibility of housing development projects, such as charging a lower / tiered fee for smaller projects.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley as follows:

1. All Affordable Units shall be offered to tenants in accordance with Council-adopted

eligibility preference criteria. All Very Low-Income Units, comprising a portion of the Affordable Units authorized and provided for by BMC Section 23.328, must be offered to tenants receiving assistance under the Section 8 Program (42 U.S.C. Section 1437f) or the Shelter Plus Care Program (42 U.S.C. Section 11403 *et. seq.*) before being marketed to other income-eligible households. The allocations shall be divided equally between the Section 8 Program (50%) and the Shelter Plus Care Program (50%). The majority of the Very Low-Income units shall be designated for the Shelter Plus Care Program when there is an uneven number of units.

2. The initial In-Lieu Fee authorized and provided for by BMC Section 23.328 shall be \$45 per square foot of the Gross Floor Area (BMC 23.106.030) for the residential portion of the Housing Development Project, as defined in BMC Section 23.328.020 and shall be automatically increased biennially based on changes to the California Construction Cost Index unless otherwise provided for by BMC Section 23.328 or by this Resolution.
3. Housing Development Projects subject to BMC Section 23.328 may provide less than the required number of Affordable Units in the Housing Development Project and pay a proportionately reduced In-Lieu Fee, calculated as follows: the fee per square foot multiplied by the total Gross Floor Area (BMC 23.106.030) of the residential portion of the Housing Development Project, multiplied by the percentage of the applicable requirement remaining after accounting for any on-site Affordable Units provided. Projects that provide no on-site Affordable Units will have an applicable requirement multiplier of one.
4. For Housing Development Projects of less than 12,000 square feet of applicable Gross Floor Area (pursuant BMC 23.328.030(B)), the In-Lieu Fee shall be calculated as follows:

Applicable Gross Floor Area (BMC 23.328.030(B))	Fee per Square Foot
12,000+	\$45
11,000-11,999	\$43
10,000-10,999	\$41
9,000-9,999	\$39
8,000-8,999	\$37
7,000-7,999	\$35
6,000-6,999	\$33
5,000-5,999	\$31
4,000-4,999	\$29
3,000-3,999	\$27
2,000-2,999	\$25
1,000-1,999	\$23
<1,000	\$21

BE IT FURTHER RESOLVED, Resolution No. 68,074-N.S. is hereby rescinded and is of no force or effect on any Housing Development Project that obtains a building permit after the effective date of this resolution, but shall continue to apply to those projects that were approved and subject to its provisions or the provisions of predecessor resolutions and ordinances addressing the same subject matter.

BE IT FURTHER RESOLVED, the rescission of Resolution No. 68,074-N.S. and this Resolution shall be effective upon the effective date of contemporaneously adopted amendments to BMC Section 23.328.



Street Level Advisors

**Updating Affordable Housing Requirements for
The City of Berkeley, CA
Analysis and Recommendations**

Revised February 2022¹

¹ Previous version: 4/27/21. See 5/5/21 PC Meeting - Item 9 – Attachment 1:
[https://www.cityofberkeley.info/uploadedFiles/Planning_and_Development/Level_3_-_Commissions/Commission_for_Planning/2021-05-05_PC_Item%209\(1\).pdf](https://www.cityofberkeley.info/uploadedFiles/Planning_and_Development/Level_3_-_Commissions/Commission_for_Planning/2021-05-05_PC_Item%209(1).pdf)

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Summary of Proposed Changes

	CURRENT	PROPOSED OPTION(S)
Ordinance	Rental: Affordable Housing Mitigation Fee (BMC 22.20.065)	Affordable Housing Requirements Ordinance (one ordinance that addresses requirements for rental, ownership and live/work units)
	Ownership: Inclusionary Housing Requirements (BMC 23C.12)	
On-site Unit Income Targets	Rental: 10% of total units @ 50% of AMI, 10% of total units at 80% of AMI	No change
	Ownership: 20% of total units @ 80% of AMI	
Base Fee	Rental: \$39,746 per market rate unit	\$45 per gross residential square foot
	Ownership: 62.5% of the difference between market and affordable price for inclusionary unit.	
VLI Incentive	40% of VLI units marketed to Housing Choice Voucher holders, 40% to Shelter+Care holders.	All VLI Units must be offered to voucher holders first (50% to Housing Choice and 50% to Shelter + Care).
Mixed Compliance Incentive	Projects that provide less than 20% on-site receive the same reduction in fee whether units are VLI or LI	More expensive/higher need VLI units reduce remainder fee by more than LI units.
Live Work and GLA	Live Work Ordinance (BMC 23E.20) exempts projects from IH and AHMF, requires 20% of live work units be affordable at 80% of AMI. Units with Group Living Accommodations (GLA) occupancy are also exempt.	Remove special exemption for Live Work and GLA units. Affirmative marketing of Live Work units to artists/others who need larger units still required.
Land Dedication	None	Create new Land Dedication Option
Family Size Unit Incentive	None	Projects that provide 2 and 3-bedroom BMR units may choose to provide 20% of total Residential Square Feet instead of 20% of units.
Condo Conversion	Nexus Fee calculation or 8% of market value. 50% reduction in fee for owner occupied units	8% of market value. 50% reduction expanded to include tenants who buy units at conversion, and nonprofit/cooperative/cohousing projects
Maximum Unit Size	None	Projects with average unit size >3BR may not choose on-site unit option
Small Project Exemption	Projects with <5 units are exempt	Exemption removed; Reduced fee for projects with fewer than 12,000 gross residential square feet, phased in as size increases. Offer a local density bonus to projects providing <5 BMR units that

		choose in lieu fee.
Cap on rent increases	BMR Unit rents increase along with HUD Area Median Income	Limit annual rent increases to the change in the Consumer Price Index

Overarching Goals for Updating Requirements:

Center racial and economic equity by reversing exclusionary zoning

Berkeley has committed to pioneering policies that attempt to undo some of the harm caused by exclusionary zoning practices. In addition to its rent control and tenant protection policies, the City’s Inclusionary Housing requirements are central to its efforts to build a more racially and economically integrated future.

Two key goals of the program are to ensure that affordable housing is included in all parts of the City and to promote the inclusion of affordable units within market-rate housing.

There has been quite a bit of academic research into the benefits of economic integration and the emerging consensus is that the location of affordable housing matters.² Much of the City’s affordable housing is concentrated in neighborhoods with the greatest health and safety challenges and the least economic opportunity. Integrating affordable housing into every neighborhood offers significant health and economic advantages, particularly for low-income children. While the same research has consistently not found additional benefits from locating affordable units in the same buildings as market rate housing (beyond the neighborhood benefits), requiring affordable units in new market rate buildings has been a key way that cities have succeeded in locating affordable housing in certain ‘high opportunity’ neighborhoods.

Currently, both the Affordable Housing Mitigation Fee (AHMF) and Inclusionary Housing Requirements (IHO) ordinances allow developers to choose to either provide on-site units or pay a fee into the City’s Affordable Housing Trust Fund program. Several recent Council referrals have focused on either reducing or eliminating the fee option in order to encourage more on-site affordable housing units in mixed income buildings. Other council referrals have called on the City to encourage payment of fees, which allow investment in non-profit owned 100% affordable projects. These projects leverage outside affordable housing funding to build more units at deeper levels of affordability and also offer critical social services.

While increasing the share of on-site affordable units continues to be an important community goal, it is important to note that this is not the only way that Berkeley is achieving the goal of

² The Urban Institute compiled a very helpful summary of several dozen research studies on the benefits of mixed income communities. urban.org/uploadedpdf/412292-effects-from-living.pdf

overcoming the legacy of segregation. Most of Berkeley falls into what is generally considered a moderate- to high-opportunity area, in part because the City offers high-quality schools to students regardless of which neighborhood they live in. At the same time, Berkeley has been successful in locating nonprofit affordable housing in most parts of the City. These broader realities reduce the pressure on the City's inclusionary housing policy to produce affordable units on-site in every building and allow the City to pursue a balanced strategy of private and publicly sponsored provision of affordable housing in every neighborhood. An appropriate goal might be for the City to target a mix of on-site units in most market rate buildings while maintaining the collection of critical fees to support nonprofit affordable properties.

Though our analysis confirmed that Berkeley's current rules appear to strongly favor payment of the fee, the actual record of projects over the past few years paints a different picture and shows that Berkeley's current policy is already achieving this kind of mix, with the majority of projects providing on-site units and paying a prorated fee.

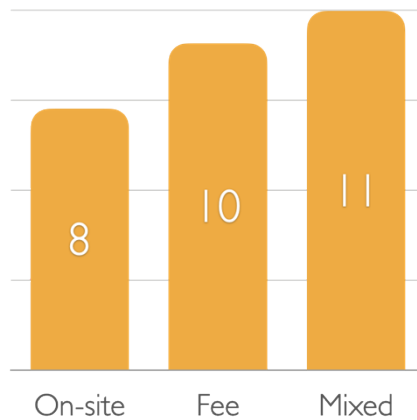
Currently, providing an on-site affordable unit is generally far more costly to a developer than paying the associated fee. Just as an example, Street Level Advisors calculated that for a hypothetical Berkeley rental property, providing one on-site Very Low Income unit would reduce the resale value of a building by about \$483,000. One on-site Low Income unit would reduce the building value by \$340,000. Opting out of providing either of those units would require payment of an Affordable Housing Mitigation Fee totaling only \$198,730.³ While the specifics differ for each building based on the local market rents, in this example on-site costs more than twice as much as paying the current fee.

We estimate that the current AHMF costs roughly \$45 per gross residential foot, and the on-site requirements cost a typical project roughly \$114 per foot.

In spite of this, between 2012 and 2020 nearly two-thirds of Berkeley's projects have included some affordable units on-site and just under one-third have fully complied through the on-site option. Figure 3 shows that the mixed compliance option (some units plus some fee) has been the most popular option. There are likely several reasons for this, including political pressures, but one clear factor is the State Density Bonus (SDB). The State requires cities to allow developers who include affordable units to build more units on a site than would otherwise be allowed and to take advantage of certain planning and zoning concessions which make it easier to get projects built. Under the current rules, projects that provide at least 11% of their base project units affordable to Very Low-Income residents qualify for the maximum benefit under the Density Bonus. These benefits cause many Berkeley projects to include 11% affordable units on-site and pay the fee for the remaining units. A recent change to state law will allow a 50% density bonus to projects that provide 15% VLI units (among other options). This change should result in even more on-site units in Berkeley even under the current City ordinance.

³ Because Berkeley requires \$39,746 per unit or 1 on-site unit for every 5 units (20%), every on-site unit that is included reduces the fee by 5 times \$39,746.

FIGURE 1: Compliance Option Selected 2012 - 2020



Encourage a mix of units and fees

The changes proposed below clarify Berkeley's policy to make on-site affordable units the preferred default requirement for both rental and ownership projects but allow payment of a fee as an alternative in order to:

- 1) continue to generate significant fee revenue to support nonprofit affordable housing projects throughout the City, and
- 2) offer flexibility for projects to choose between multiple compliance options depending on different circumstances.

Ideally, the proposed changes will encourage a mix of fees and units over time with fees coming primarily from projects where on-site units would be less feasible (e.g. due to economies of scale) or more difficult to monitor.

The proposed Affordable Housing Requirements ordinance would be structured so that providing on-site units is the default requirement for nearly all projects, with an exception for small projects and co-living type projects which would be encouraged to pay the fee. It might be possible to remove the fee option entirely, but state law requires cities to offer multiple compliance options such as a fee in their inclusionary housing ordinances. Ideally, the program would be structured such that the cost to a project of providing units on-site is more similar to the cost of paying the fee. This would maintain flexibility but reduce the incentive to pay the fee rather than provide units.

Over time, strong demand for housing in Berkeley should mean that higher fees are practical, but our analysis of current market conditions suggests that 2021 is a particularly risky time to raise Berkeley's housing fees. The Covid-19 pandemic has created uncertainty in the real estate market and led to falling rents throughout the region. The multi-family rental prototypes we studied earned returns that were just barely above the minimums required for financial feasibility. The recommendations below call for restructuring the fee to be calculated on a per square-foot basis but setting it, for the moment, at a level which is financially comparable to

the current fee for most projects. Once the housing market has recovered from the effects of the pandemic, we recommend evaluating a fee increase which would bring the cost of the fee option closer to the cost of on-site compliance.

More immediately, the proposed changes recognize the growing popularity of mixed compliance based on the State Density Bonus and aim to increase the number of on-site units primarily by increasing the prevalence of these mixed compliance projects. Together these changes should increase the number of affordable units provided on-site within market rate projects throughout Berkeley without dramatically reducing the affordable housing fee revenue that the City's HTF program receives.

Continue Berkeley's legacy of value capture

A key goal of Berkeley's inclusionary housing ordinance and Affordable Housing Mitigation Fee has been to ensure that new real estate development projects in Berkeley contribute benefits for the whole community. This principle of Public Value Capture (or Land Value Capture) calls on the City to closely evaluate the profitability of real estate projects and set its housing requirements at a level which captures a share of the profits to support housing for our lowest income residents. Careful value capture requires close attention to the financing and economic realities of development in order to ensure that the City is capturing the appropriate amount of financial returns.

Appendix A contains a detailed description of Street Level Advisors financial feasibility study. Building on past studies conducted in support of Berkeley's Affordable Housing Mitigation Fee, we analyzed a single hypothetical rental and a single condominium building prototype in order to better understand the financial feasibility of these projects under the current program and under the proposed changes described below.

For rental projects, our model suggests that most projects would not be able to feasibly comply with the current 20% on-site requirement but that projects that choose to pay the fee or access the State Density Bonus by providing some units on-site and paying a partial fee would both earn returns that are just barely above the threshold we identified for feasibility (5% yield on cost). The returns for density bonus projects are comparable to the fee alternative because the additional cost of providing some units on-site is offset by the additional benefit of building more units on the same site.

For our rental prototype (described in Appendix A), the proposed fee of \$45 per gross square foot results in a virtually identical return to what the project would see under the current fee. A higher fee (\$55 per square-foot) would result in a marginal return. The proposed approach of providing more 'credit' for projects that provide on-site VLI units than those that provide LI units results in modest increases in the returns available to mixed compliance projects that take advantage of the State Density Bonus. While this small difference is not critical for this prototype, it is likely that there would be projects where this difference would result in on-site

affordable units in projects that would otherwise have paid the fee entirely (or not moved forward at all).

Figure 2: Comparison of Returns - Rental

Scenario	Base Units	Bonus Units	LI Units	VLI Units	Fee \$	Yield on Cost	% of Base	% of Total
Current Policy								
\$39,746 Per Unit Fee	72	0	0	0	\$2,861,712	5.08%	0%	0%
Onsite Units	72	0	7	7	\$0	4.94%	19%	19%
Mixed Compliance - 11% VLI	72	25	0	8	\$2,265,522	5.07%	11%	8%
Mixed Compliance - 15% VLI	72	36	0	11	\$2,106,538	5.10%	15%	10%
Proposed Alternatives								
\$45 Per Foot Fee	72	0	0	0	\$2,967,750	5.07%	0%	0%
\$55 Per Foot Fee	72	0	0	0	\$3,627,250	4.99%	0%	0%
Mixed Compliance (Weighted) - 11% VLI	72	25	0	8	\$2,350,809	5.10%	11%	8%
Mixed Compliance (Weighted) - 15% VLI	72	36	0	11	\$2,184,925	5.12%	15%	10%

For ownership projects, there is no Yield on Cost metric; feasibility is generally evaluated based on the profit from sales as a percent of the total development cost. Because there have been very few recent condo projects in Berkeley, it is not possible to identify the exact threshold for feasibility. One common benchmark considers projects that earn more than 10% profit to be “feasible.” We found that neither the current fee nor the current on-site requirement resulted in profit as a percent of development cost above this 10% threshold. The proposed switch to a \$45 per square-foot fee would result in profit just above 10% while a higher \$55 per square-foot fee would result in profit closer to 9%.

Figure 3: Comparison of Returns - Ownership

Scenario	Total Units	LI Units	Fee \$	Profit % of Cost
Current Policy				
Current Fee (based on sale prices)	56	0	\$3,810,847	8.00%
Onsite Units	56	11	\$0	1.13%
Proposed Alternatives				
\$45 Per Foot Fee	56	0	\$2,767,050	10.88%
\$55 Per Foot Fee	56	0	\$3,381,950	9.16%

Continue progress on housing goals

The Bay Area and the Berkeley community need more housing. Rapidly rising housing costs and growing displacement pressures are the result of a systemic shortage of housing. While building more housing alone would not be sufficient to address the current inequities, we cannot

overcome our housing challenges without building significantly more housing. The Regional Housing Needs Allocation (RHNA) requires Berkeley to permit nearly 9,000 new homes at all income levels during the period from 2023 to 2031.

To meet this historic challenge, Berkeley's affordable housing policies must balance two critical but competing goals.

- 1) We must set affordable housing requirements high enough to produce meaningful levels of affordable housing, and
- 2) We must ensure that they are not too high for developers to accommodate.

If Berkeley sets its requirements too low, it may see construction that only serves to further existing inequity and racial exclusion. But if requirements are set too high, the result could be that little or no new housing is built, which would itself perpetuate the inequities which drive ongoing displacement of existing residents and push prices and rents up to levels which effectively prevent new low- and moderate-income households, including many households of color, from moving to Berkeley.

Berkeley's current affordable housing requirements (both the on-site requirements and the fee options) are somewhat higher than other East Bay jurisdictions (see Figure 6 below). But in spite of the relatively high costs, construction is continuing in Berkeley. Even during the pandemic, builders continue to undertake new residential projects. This suggests that Berkeley's requirements do not dramatically overburden development. However, Street Level Advisors' feasibility analysis (Appendix A) finds that the current requirements are only marginally financially feasible in today's environment. This suggests that Berkeley could see more building overall - including more affordable housing development - by slightly reducing the cost of compliance for some projects.

The proposed changes include many small adjustments to current requirements intended to make it easier for developers to understand and comply with program rules and for the City to oversee and administer. This will also facilitate transparency for the community at large. These changes are explicitly intended to make it easier to build the new housing that Berkeley desperately needs. However, the proposed changes attempt to achieve this while simultaneously maintaining or increasing the overall contribution that new market-rate housing makes to the provision of affordable housing in Berkeley.

Under the proposed changes, some types of projects are asked to contribute more and others less (relative to the existing inclusionary requirements), but the goal is to maintain or increase the number of on-site units and the amount of fees available to the HTF program. The proposed changes do this by reducing the fee assessed to projects with relatively smaller units and increasing the fee on projects with large or extra large units. They will also slightly reduce the fee due from projects that provide some units on-site. These changes should encourage more projects to build some units on-site while also improving overall feasibility so that more housing projects are able to move forward.

Work within the City's existing administrative capacity

Berkeley's current affordable housing requirements are among the most complex in the region, but the City has fewer administrative staff than many other jurisdictions. HHCS currently has a total of 1.3 FTE to implement the BMR program:

- 0.20 FTE to work on new projects (apply requirements, meet with applicants, draft and execute regulatory agreements);
- 1.0 FTE monitor for completed projects, funded by an annual monitoring fee on BMR units; and
- 0.10 FTE related policy work and program supervision.

Adopting changes to the City's affordable housing requirements that increase administrative requirements would only be possible if new General Funds could be identified to support the implementation. As the City's BMR portfolio expands, funding for an additional monitor should be a consideration as well. Implementing local affordability requirements is not an eligible use of federal funds, so local funds are required to support this activity.

The proposed changes described below add complexity to the rules in several places but attempt to offset the complexity by streamlining and eliminating administrative challenges in several other places. The goal is to design a program which the City can successfully implement with existing staffing resources.

Proposed Changes in Detail:

1. Consolidate Affordable Housing Requirements into a single framework

Proposed Changes:

- 1.1. Combine the requirements of the Affordable Housing Mitigation Fee (AHMF) and Inclusionary Housing (IH) ordinances into a single “Affordable Housing” ordinance which would impose on-site affordable housing requirements for both ownership and rental projects.
- 1.2. The fee would be structured as an “in lieu fee” offered as an alternative to on-site units, rather than as a mitigation fee.
- 1.3. The new ordinance would also replace the affordable housing requirements sections of the Condo Conversion and Live/Work ordinances.
- 1.4. To the extent possible, standardize the requirements that are applied to different projects to simplify implementation of the program.
- 1.5. The new ordinance would apply to all new project applications received after a date specified several months after adoption.

Background and Analysis:

Prior to 2009, Berkeley had a single Inclusionary Zoning Ordinance (BMC Chapter 23C.12) which applied to both ownership and rental projects. In 2009, a Court of Appeals decision known as *Palmer/Sixth Street Properties LP v. City of Los Angeles* prevented California jurisdictions from enforcing inclusionary housing requirements on rental properties. Like many other cities, Berkeley responded by adopting an Affordable Housing Mitigation Fee (AHMF) (BMC section 22.20.065). Instead of requiring on-site units and then offering an in lieu fee as an alternative, the AHMF ordinance requires payment of a fee and allows the provision of on-site units as an alternative. This approach allowed Berkeley to achieve its policy goals without violating the restrictions imposed by the Palmer decision. But it created a situation in which the City had two different ordinances that attempt to impose similar requirements. The provisions of the Inclusionary Housing Ordinance that applied to rental housing remained in the Berkeley Municipal Code but were unenforceable and superseded by the AHMF ordinance.

In 2018, the California Legislature passed AB1505 which effectively overturned the Palmer decision and authorized the implementation of inclusionary housing requirements applied to rental properties. This legislation has allowed a number of cities to update their programs to combine rental and ownership requirements under a single inclusionary housing ordinance.

For example, in June 2019, the Mountain View City Council completed a two-phase process to update its Below Market Rate Program requirements. Mountain View now requires any new residential development, whether rental or ownership, to provide 15% of its units at affordable

rents.⁴ Similarly, after suspending its inclusionary rental housing requirement in 2011 to comply with the Palmer decision, the City of Menlo Park updated its Below Market Rate Housing Program to subject all new residential developments to its affordable housing requirements.⁵

Berkeley's new Affordable Housing Requirements (AHR) ordinance would address both rental and ownership projects (including Live/Work and Group Living Accommodations) and would impose an on-site affordable housing requirement for both while allowing payment of an in lieu fee.

2. Calculate the fee on a per square-foot basis

Proposed Change:

- 2.1. Calculate affordable housing fees on a per square-foot basis instead of per unit. Initially set the fee at \$45 per gross residential square foot, which is roughly equivalent to the current fee for projects with typically sized units. Collect the fee at the time of Certificate of Occupancy eliminating the current discount for earlier payment. Increase the fee amount automatically based on the change in the California Construction Cost Index.

Background and Analysis:

Some stakeholders have expressed concerns that projects that propose units with large numbers of bedrooms are not being required to pay an appropriate fee. Because Berkeley charges its AHMF on a per unit basis, a project that chooses to include a number of 5-bedroom units for example, would pay far less proportionally than a similarly sized project with studio, 1- and 2-bedroom units. It is not clear whether this savings is enough to cause developers to choose much larger bedroom configurations since these large unit 'co-living' projects are a trend nationwide. But it is clear that Berkeley's ordinance creates an incentive for projects that select this configuration and there does not seem to be a public policy reason for Berkeley to prefer these extra-large units. While there are benefits to projects that include 'family sized' 2 and 3-Bedroom units (discussed in proposed change #9 below), beyond 3 bedrooms, new units are generally housing multiple unrelated individuals rather than families.

A number of cities have changed to calculating in lieu fees on a per square-foot basis. San Francisco and Santa Barbara both made this change in 2019 and San Jose made a similar change in early 2021. Instead of charging a flat fee per unit, the City would charge the fee for each square foot of residential space in the building regardless of how the building is divided up into

⁴ City of Mountain View, Below Market Rate Program, <https://www.mountainview.gov/depts/comdev/preservation/homebuying/bmrhousing/default.asp>

⁵ City of Menlo Park, BMR Requirements for Residential Developers, <https://www.menlopark.org/DocumentCenter/View/1493/BMR-Requirements-for-Residential-Developers>

units. As an example, a 25,000 square foot building would pay the same fee whether it was split up into 50 small studios or 15 multi-bedroom co-living units.

Currently, in Berkeley, every rental project would pay \$39,746 per unit (assuming that they provided no units on-site). For a typical project, this is equivalent to a fee of \$45 per gross residential square foot, as illustrated in the table below.

“Gross Square Feet – Residential” is defined as all of the square footage of a new building (as defined in BMC 23F.04.010) minus any exclusively commercial space or indoor parking area. In a typical project, the gross square footage is roughly 1.25 times the net square footage.

We conducted a market analysis in order to estimate a per square-foot fee which would be equivalent to the current AHMF. We collected data on the unit sizes of 18 recent Berkeley projects. We then multiplied the average unit sizes by 1.25 to estimate the gross square footage of each of these projects. For each project, we calculated an ‘equivalent per square-foot fee’ by dividing the fee that the project would have paid under the current rules (assuming no on-site units) by the gross square footage. The equivalent per square-foot fees ranged from \$38 to \$65. The typical fee was approximately \$45 which corresponds to an average unit size of 705 square feet.⁶ Figure 4 shows the distribution of average unit sizes and equivalent square foot fees.

Figure 4: Impact of unit size on equivalent square foot fee calculation

⁶ This excludes several outlier projects with very large or very small units.

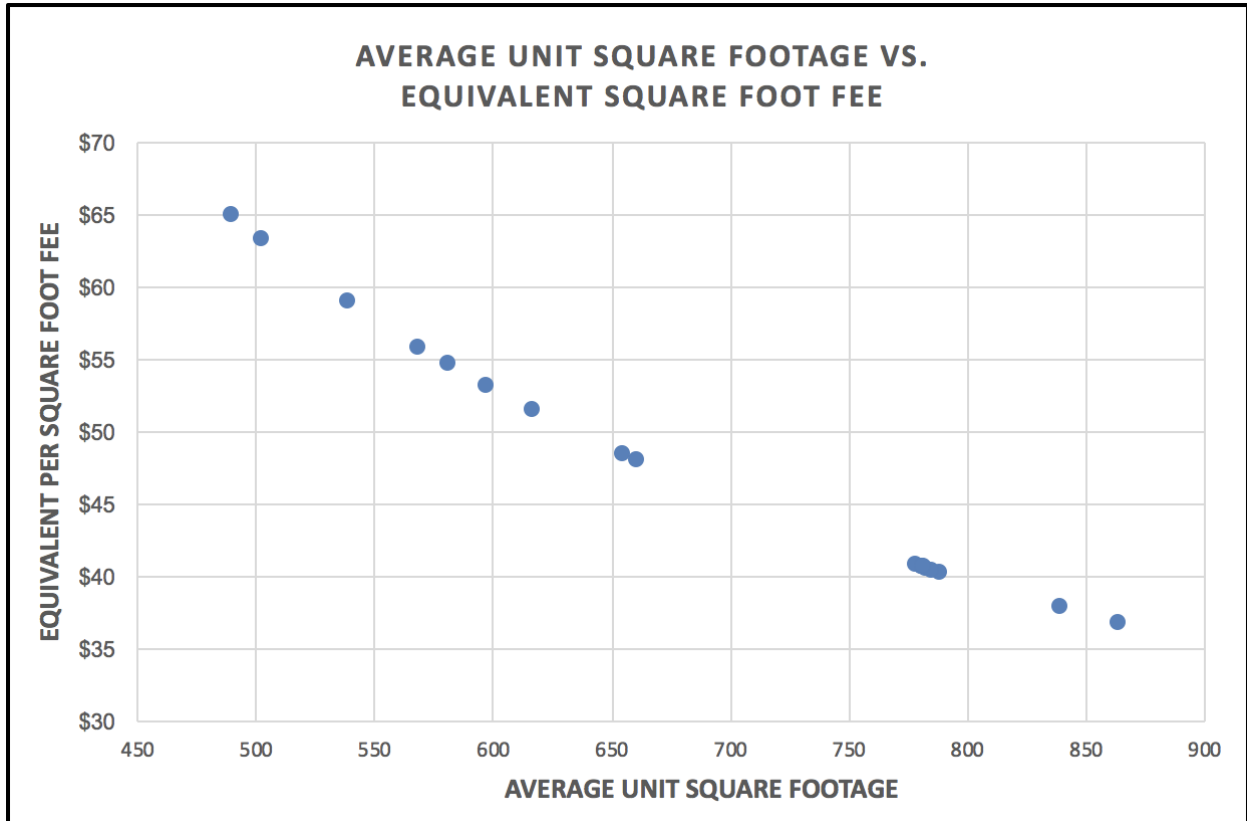


Figure 5 shows a sample of recent projects in order to illustrate the impact of switching to a per square-foot fee. Under the current per unit fee, projects that have the same number of units like Avalon and Hillside Village would pay the same amount of fee. The equivalent per square-foot fees (\$37.91 vs. \$48.14) show that Avalon is getting a much better deal by paying less relative to its size.

The per square-foot fee adjusts for the difference in project sizes. If Berkeley switched to a standard fee of \$45 per square-foot, projects with small units such as the Delaware Apartments would pay a lower total fee while projects with large units such as Higby would pay higher total fees.

Figure 5: Equivalent per foot fees for recent projects - Examples

Project Name	Total Units	Average Unit Square Footage	Current Fee (Assuming \$39,746 per unit)	Equivalent Per square-foot Fee	Projected Fee (assuming \$45/sq.foot)
Higby	98	864	\$3,895,108	\$36.82	\$4,760,145
Avalon	94	839	\$3,736,124	\$37.91	\$4,434,615
Stonefire	98	782	\$3,895,108	\$40.65	\$4,311,900
Hillside Village	94	661	\$3,736,124	\$48.14	\$3,492,405
The Dwight	99	617	\$3,934,854	\$51.57	\$3,433,680
The Delaware	51	581	\$2,027,046	\$54.72	\$1,667,025

For comparison, Figure 6 provides fee levels for nearby jurisdictions.

Figure 6: Comparison of Inclusionary Housing Requirements and Fee Levels for Other Jurisdictions

City	% Affordable Housing Required On-site	Fee	Notes
Alameda	15% for all multifamily projects	\$20,342 Per Unit	No alternative to fee for buildings of 9 or fewer units
Emeryville	20% for all multifamily projects	\$31,032 Per Unit	
Fremont	12.9% for rental	\$27.00 Per Residential Square Foot	
Hayward	6% for rental, 10% for ownership	\$19.37 Per Residential Square Foot	Lower fees for high-density condos
Livermore	10% downtown, 15% everywhere else	\$29.23 Per Residential Square Foot	Projects with 10 or more units may not pay fee
Oakland	10% if low- or moderate- income units, 5% if very low-income units	For multi-family: \$22,000 per unit in Zone 1, \$17,750 in Zone 2, \$12,000 in Zone 3	
Pleasanton	15% for all multifamily projects	\$45,083 per unit	
San Francisco	20% for small projects, 25% for large rental, 33% for large ownership	\$199.50 Per Gross square foot times affordable percent	Equivalent to \$60 per square-foot for many projects.
San Jose (proposed)	15% for all multifamily projects	Moderate Market Areas: \$18.26 per net residential foot Strong Market Areas: \$43	

The current AHMF ordinance allows developers to choose between paying a higher fee (currently \$39,746) at the Certificate of Occupancy when a project is nearly complete or a reduced fee (currently \$36,746) earlier when a project receives a building permit. Nearly all projects have selected the higher fee because of the high value that developers place on the ability to pay the fee later. Paying later reduces their financing costs and lowers their overall financial risk. Removing the option to pay early would recognize this reality and eliminate an additional element of administrative complexity and communication challenge.

The existing Affordable Housing Mitigation Fee is automatically adjusted by the annual percentage change in the California Construction Cost Index published by the California Department of General Services, every other year. The automatic adjustment is applied to all projects that have not received final approval by the City of Berkeley prior to the date of the automatic adjustment. This automatic adjustment ensures that the fee keeps pace (roughly) with what it costs the City and its nonprofit partners to construct new affordable housing using the fee revenue. This method should remain in place.

3. Evaluate the potential for higher fees when the market is stronger

Proposed Change:

- 3.1. In order to encourage more on-site units, phase in a slightly higher fee once the housing market has stabilized. Conduct an updated feasibility analysis within 3 years, increase the per square-foot fee if the analysis shows that typical projects could support the higher fee.

Background and Analysis:

Under current market conditions, Berkeley's on-site compliance option (20%) is significantly more costly for most projects relative to the cost of the Affordable Housing Mitigation Fee or In-lieu Fee. This creates an incentive for projects to choose to pay the fee instead of providing units on-site. In spite of this incentive, the majority of projects have provided some level of on-site units because the State Density Bonus provides an even stronger incentive to include affordable units on-site, and the units count against the fee obligation as well.

Ideally, the on-site unit and in-lieu fee requirements would be more closely aligned so that they represented similar costs for most projects. This kind of alignment would likely result in a higher number of on-site units without entirely eliminating the fee revenue which is critical to Berkeley's HTF program. Aligning the economics of these two options would require either raising the fee or lowering the on-site requirement considerably.

In rough terms, the on-site requirement would need to be lowered to about 15% in order to represent a cost to most rental projects that was equivalent to the cost of the current AHMF. However, none of the local stakeholders we spoke with suggested that there would be public support for lowering Berkeley's on-site requirement.

A number of stakeholders, on the other hand, suggested raising the fee. This seems to be the more obvious path to aligning the cost of the two options and increasing the share of units on-site. However, our feasibility analysis (Appendix A) suggests that 2021 would be a particularly risky time to raise the affordable housing fee. The Covid-19 pandemic has created uncertainty in the real estate market. Rents in Berkeley have fallen significantly and rents in high-cost newly constructed buildings may have fallen more than the average. At the same time, construction costs have not (yet) fallen leaving most multi-family housing developments in a precarious position. Builders are still moving forward with new rental buildings in Berkeley but the City's volume of new applications has fallen relative to recent years. It seems likely that Berkeley will continue to be a desirable location for new housing over the long term but it is not yet clear whether there will be a protracted slow down in new building throughout the region following the pandemic.

While the level of local fees, including affordable housing fees, is just one small factor that developers consider when they decide whether or not to move forward with a project, Berkeley already charges more than most other East Bay jurisdictions and increasing the fee at this time could contribute to a greater slow down in new building.

For this reason, we are recommending that Berkeley allow for a period of housing market recovery before considering an increase in the Affordable Housing Fee. The City could plan on an update to the feasibility analysis in one to three years or wait for evidence that either rents have begun increasing or that construction costs have begun to fall before reconsidering the level of the fee.

4. Incentivize Extremely Low-Income (30% of AMI) units

Proposed Changes:

- 4.1. Require all VLI Units to be offered to voucher holders (50% to Housing Choice Voucher Holders and 50% to Shelter + Care Voucher Holders) before being marketed to other income eligible households.

Alternative:

- 4.2. Retain the current rules which require 40% of VLI units be offered first to Housing Choice Voucher Holders and another 40% be offered first to Shelter + Care Voucher Holders.

Background and Analysis:

A number of local stakeholders have expressed a desire to see Berkeley's program provide relatively more units to serve Extremely Low-income (ELI) households (below 30% of Area Median Income) who face the most acute housing challenges.

Some cities achieve this by creating a formula which allows developers to substitute a smaller number of units targeting Extremely Low Income residents for some portion of otherwise required on-site BMR units. Los Angeles's Transit Oriented Communities (TOC) program requires affordable units in exchange for a significant density bonus. The TOC program allows developers to choose between providing a greater number of low-income units or a smaller number of more deeply affordable Extremely Low Income units. Even though the rents on the ELI units are much lower, many developers have chosen this option because they can provide fewer affordable units (and more market rate units). Between 30% and 50% of the BMR units produced through the program have targeted ELI households and this program has driven a significant increase in the total number of income restricted ELI units produced in LA. In 2020, 34% of new BMR units in LA were restricted to ELI tenants.

While this type of approach might increase the number of ELI units in Berkeley, it is worth noting that Berkeley is already a national leader in serving ELI households through inclusionary housing. *Currently 29% of Berkeley's BMR tenants have incomes below 30% of AMI* and the share of ELI tenants is likely to increase noticeably under current rules. Berkeley's AHMF requires that at least half of BMR units must target 50% of AMI and, *of those*, 40% must be offered first to Housing Choice voucher holders from the Housing Authority and another 40% must be offered first to Shelter Plus Care voucher holders managed by the City's Housing and Community Services division. Voucher holders in both programs generally have incomes well below 30% of AMI. And because of the acute shortage of inexpensive market rate housing, most of the households that receive vouchers in Berkeley are unable to use them in the market. This approach has benefits for developers as well. The City allows the property to receive the contract rent offered by the subsidy program as long as the tenant's share of rent is below the BMR limit. The contract rents are generally far below the market rent for brand new buildings but also quite a bit higher than the BMR affordable rent for 50% AMI units. Because of the voucher, the ELI tenants, on the other hand, generally pay much less than the 50% AMI affordable rent.

In addition, because of the way Berkeley's requirements interact with the State Density Bonus (SDB), developers tend to favor the 50% AMI units. As a result, 77% of Berkeley's BMR units approved since 2012 have been regulated as 50% AMI units. If this pattern continues and, going forward, 80% of these units are reserved for voucher holders, then we would expect voucher holders to make up 62% of new BMR tenants.

A 2020 State law (AB 2345) expands the SDB beginning in January 2021. Developers will now be allowed to build 50% more units if they provide at least 15% VLI units (among other options). This new law should result in a greater number of on-site VLI units and, as a result, a greater number of ELI/voucher tenants. At some point, it is likely that the City would exhaust

the supply of unused vouchers and some of these units would ultimately be leased to Very low Income tenants (below 50% of AMI) instead.

In addition to its success in serving ELI tenants in BMR units, the City currently requires that at least 20% of units in all projects funded with the Housing Trust Fund be affordable to ELI tenants.

Requiring that all VLI units first be offered to voucher holders would slightly increase the share of ELI tenants housed going forward while also removing an element of complexity from the program and simplifying otherwise complex rounding issues.

5. Adjust the residual fee for mixed compliance projects

Proposed Change:

- 5.1. Encourage more mixed compliance projects by changing the calculation of the remaining fee due when projects provide less than 20% affordable units on-site. Restructure the remainder fee so that providing VLI (50% AMI) units reduces the fee due by more than providing LI (80% AMI) units.

Alternative:

- 5.2. Continue the current practice of providing the same reduction in fee for any units, whether they serve VLI tenants or LI tenants.

Background and Analysis:

Currently rental projects that provide 20% affordable units on-site are exempt from the Affordable Housing Mitigation Fee (AHMF). Half of these units must be for Very Low Income (VLI) residents earning less than 50% of AMI and half must be for Low Income (LI) residents earning less than 80% of AMI. When a developer provides a portion of the required units on-site, the City has a formula that is used to determine the remaining fee. For example, if a project provides half of the required on-site units, they also owe half of the fee that would have been due. In order to access the benefits of the State Density Bonus, the majority of recent projects have selected this mixed compliance option.

Under the current rules, providing any on-site affordable housing unit reduces the fee that is due by the same amount regardless of whether the unit provided is a LI or a VLI unit. But because the VLI units rent for much less, they are much more costly to provide on-site. When a developer agrees to provide any permanently affordable unit, they will receive less rental income from that unit throughout the life of the project than they would from a market-rate unit. As a result, each affordable unit in a project decreases the value of a building - the amount that a building could be sold for. Street Level Advisors estimated the cost of providing these units on-site for a hypothetical six story project and found that a VLI unit reduces the value by \$483,000 while a LI unit reduces value by \$340,000.

One way to encourage more projects to provide some units on-site would be to restructure the remainder fee so that providing VLI (50% AMI) units reduces the fee due by more than providing LI (80% AMI) units. Based on the relative affordable rents, providing 10% VLI units could relieve the developer of \$30 of the \$45 per square-foot remainder fee, while providing 10% LI units could relieve them of only \$15 of the \$45 per square-foot fee. Projects providing fewer than the 10% of units required in either category would pay a fee adjusted proportionally.⁷

Figure 7: Examples to illustrate partial compliance - 100 unit project

Example	VLI units	LI Units	Fee
On-site Only	10	10	\$0
Fee Only	0	0	\$45
Only VLI	10	0	\$15
Only LI	0	10	\$30
Half Each	5	5	\$22.50
11% VLI	11	0	\$12
15% VLI	15	0	\$0

This change would increase the feasibility of the mixed compliance options and should result in on-site units from some projects that would have otherwise selected to pay the fee. However it is important to note that this mixed compliance option is already the most popular option and appears to be financially feasible without this change.

6. Standardize ownership fees

Proposed Change:

- 6.1. Apply the same per square-foot fee for both rental and ownership units. Continue to require different income targeting for ownership units.

⁷ The formula for calculating the reduction in fee could be $(\text{Full Fee} * 1.33 / 20) * (\text{actual \% of VLI units}) + (\text{Full Fee} * .67 / 20) * (\text{actual \% of LI units})$. If the full fee is \$45 per square-foot, then each 1% of VLI units would reduce the fee due by \$3 per square-foot and each 1% of LI units would reduce the fee by \$1.50 per square-foot.

Alternative:

- 6.2. Charge any project that chooses to record a Condominium Map a higher fee of \$55 per square-foot.

Background and Analysis:

Many local stakeholders are under the impression that Berkeley’s current Inclusionary In-Lieu Fee for ownership projects is higher than the Affordable Housing Mitigation Fee for rental projects. Berkeley has seen very few ownership projects in recent years, so it is difficult to directly compare, but our analysis suggests that this is true, both on a per unit and per square-foot basis.

In lieu of each affordable unit, the current Inclusionary Housing Ordinance allows payment of a fee equal to 62.5% of the difference between the market price and the “affordable” price. To estimate the equivalent per square-foot fee that this rate yields, we used proprietary data from Property Radar to calculate average square footages and market values for Berkeley condos, shown in Figure 8.

Figure 8: Condo pricing estimates

Berkeley Condo Sales 2021			Prototype (New Building)
Unit Size	Avg Sqft	Avg Value	Projected Value
Studio	646	\$620,752	
1-BR	814	\$703,556	\$725,000
2-BR	1117	\$853,125	\$925,000
3-BR	1571	\$995,797	\$1,100,000

It is likely that newly built condos would sell for higher than average prices but there have not been enough Berkeley condo projects in recent years to calculate appropriate projections for new buildings only. We have assumed sale prices for newly built condo units would be roughly 5 to 10% higher than the citywide average condo sales prices.

The IHO defines the affordable price for the purpose of calculating the fee as three times (3x) the Area Median Income (AMI) adjusted for household size. We used those prices to estimate in lieu fees. We then multiplied those numbers by 20% to yield the equivalent per unit fee, which range from \$48,000 to \$85,000. This suggests that the fees required for ownership projects in the IHO are indeed higher than the \$39,746 per unit currently required for rental

projects under the AHMF. Our estimates for the equivalent per square-foot fees for ownership projects range from \$54 to \$75, which is higher than the typical equivalent per square-foot fees that we found for rental projects. Projects with very high cost condo units would face even higher fees.

Figure 9: Estimated BMR Ownership Fees 2021

Unit Size	Sq Ft	Market Price	Affordable Price	In Lieu Fee	In Lieu Fee Per Unit	In Lieu Fee per Sq Ft
Studio	646	\$620,752	\$234,960	\$241,120	\$48,224	\$75
1BR	814	\$703,556	\$250,650	\$283,066	\$56,613	\$70
2BR	1117	\$853,125	\$282,000	\$356,953	\$71,391	\$64
3BR	1571	\$995,797	\$313,200	\$426,623	\$85,325	\$54

Note that the median condo value in Berkeley has risen dramatically in recent years, from a low of \$364,000 in 2012 to \$900,000 in January 2021.⁸ Because prices have risen much faster than income, the in lieu fee has risen too.

We analyzed the financial feasibility of the current fees for hypothetical affordable ownership projects (Appendix A) and found that the current fees resulted in profits that fall below commonly used benchmarks for necessary profit. High cost condos might be able to pay the fee and earn the minimum required profit but projects with sales prices closer to Berkeley's average condo prices were not. However, under current conditions, more typically priced condos were able to pay the proposed rental fee of \$45 per square-foot and remain financially feasible. While there have not been enough condo projects in Berkeley recently to draw strong conclusions, this exercise lends support to the assertion that the relatively high level of Berkeley's fee for ownership projects is contributing to developer's choice to build rental rather than ownership housing.

The current policy appears to discourage homeownership development. Some local stakeholders have expressed an interest in adjusting the policy to give developers, and ultimately Berkeley residents, more choice between rental and homeownership housing. Setting the fee at \$45 per square-foot for both types of project would level the playing field considerably. The typical ownership unit would still pay more because ownership units tend to be larger. As an alternative, many cities charge homeownership units slightly more. Setting

⁸ Zillow Home Value Index for Condos/Co-ops, <https://www.zillow.com/berkeley-ca/home-values>

Berkeley's fee at, for example, \$55 per square-foot for ownership projects would slightly disincentivize ownership but by less than the current fee approach.

Addressing rental projects that record condo maps

Another reason to consider standardizing the fee between rental and ownership projects stems from the fact that a growing number of new multi-family buildings are recording condominium maps but opening initially as rental housing projects. This gives project owners the flexibility to later sell the rental units as condos if housing market conditions change. The added flexibility makes it easier for developers to access project financing or to access financing on better terms.

For projects that provide on-site affordable rental units, the City records restrictions which require that the BMR units remain affordable rentals for the life of the project. But the potential for projects that are initially rental and pay the AHMF but later convert to ownership is not addressed in Berkeley's current code. Projects that paid the AHMF as rental projects and later sold condo units would owe an additional fee, but monitoring and collecting this fee is administratively and legally challenging.

Some cities have responded to this trend by requiring projects that record a condo map when they are first built to pay a higher affordable housing fees that would be due for ownership projects even if the building is initially operated as rental housing. This would not be practical under Berkeley's current approach because the ownership in lieu fee is set based on the actual sale price of units but those may not be determined for many years (if ever). Setting a single in lieu fee that would be applied to both rental and ownership projects at the time of development would eliminate this complexity. Alternatively, setting a higher fee per square-foot for projects with a Condo Map would also provide a practical alternative, though it might increase costs on rental projects that are not likely to ever actually convert to ownership but need the Condo Map in order to access certain financing sources.

7. Standardizing Live Work and GLA requirements

Proposed Change:

- 7.1. Remove the exemption for Live / Work projects from IHO/AHMF ordinances; apply the same requirements to Live / Work projects as any other project except for the "affirmative marketing" provision
- 7.2. Remove the exemption for units with Group Living Accommodations (GLA) tenancy (and consider retaining an exemption for University-recognized GLAs)

Background and Analysis:

A 2018 Council Referral (2018-09-12, Item 17) called for the elimination of the affordable housing requirements in the Live Work Ordinance and removal of the live/work exemptions

from both the IHR and AHMF ordinances. This action would simply apply the Inclusionary Housing or AHMF ordinances to Live Work exactly as they are applied to other projects.

Live/Work units are currently exempt from both the Inclusionary zoning ordinance and the Affordable Housing Mitigation fee. Instead, Berkeley's Live Work Ordinance (Berkeley Municipal Code 23E.20) requires projects that create 5 or more Live/Work units to include 1 inclusionary unit affordable to 80% of AMI for every 5 Live/Work units created. The inclusionary requirements in the Live/Work ordinance differ from the requirements applied to other projects. Affordable units under the Live/Work ordinance are all targeted to 80% of AMI. In addition, the Live Work Ordinance specifically allows inclusionary Live/Work units to be smaller, have lesser finishes and be located anywhere in a project while both the IHR and AMHF ordinances require units to be the same size, have comparable finishes and be distributed throughout a project.

There is one provision of the Live/Work ordinance which is specific to Live/work affordable units which it would make sense to retain or move to the new ordinance. Inclusionary live/work units must be affirmatively marketed to "income-eligible persons performing a work activity permitted in the District where the project is located whose type of work causes them to have a requirement for a space larger in size than typically found in residential units." The ordinance currently provides no standards for documenting tenants' need for live/work space or rules for waiving this requirement in the event that a tenant with this need cannot be found within a reasonable period.

The ordinance currently exempts Group Living Accommodations (GLA) units, but because this classification represents a type of tenancy rather than a specific type of unit, it would make sense to subject GLA units to the Affordable Housing Requirements like any other unit. Fraternities, sororities, and other specially designated units managed by the University would retain their exemption. Further study could be necessary to assess the impact of this change on project feasibility.

8. Add a land dedication option

Proposed Change:

- 8.1. Add a land dedication option which authorizes the City Manager to approve donation of land to the City or an approved nonprofit housing developer. Donated land must be appraised for a value of at least 75% of the in lieu fee which would otherwise be due, be sufficiently sized and zoned to support multifamily housing development and otherwise be suitable for affordable housing development.

Alternative:

- 8.2. Don't add a land dedication option - continue with two compliance options; on-site units or in lieu fee, though this would leave projects newly excluded from the on-site option with only one compliance option.

Background and Analysis:

Some stakeholders have suggested that the program would be stronger if Berkeley allowed developers to comply by providing off-site affordable projects, preserving existing ‘naturally occurring affordable housing’ or dedicating land for affordable housing development. We evaluated the feasibility of adding off-site and preservation options and concluded that Berkeley currently lacks the staff capacity necessary to effectively implement these complex options. However, it is worth noting that the City can and does use in lieu fee revenue collected to finance both off-site projects and preservation/rehabilitation projects. By collecting fees and then going through the existing procedures for the HTF and Small Sites programs, the City avoids the need to develop new detailed rules and closely monitor developer implementation of these alternatives.

The third option, land dedication, however, provides an outcome which the City cannot achieve on its own through the use of fee revenue. While this option also would require detailed rules to avoid abuse, it may be less challenging than off-site or preservation options and is likely to be used in far fewer cases.

Access to sites is one of the key barriers facing affordable housing developers. Market rate developers sometimes end up with control over sites which could be better used for affordable housing. Sometimes market rate projects are large enough to set aside a portion for affordable housing. In these, somewhat rare, cases, it is sometimes more affordable for the developer to donate land for affordable housing than to build on-site units or pay an in lieu fee. If the donated site is appropriate for affordable housing, it can save significant time and make new projects possible. Of course, if sites are not appropriate, land donation can result in a significant burden on City resources. If the policy were to include a land dedication option, the City would need to develop detailed guidelines which outlined site requirements and retain the option to only accept sites when there is a high probability that they will be developable for affordable housing including, for example, expressions of interest from local affordable housing developers.

9. Provide a family sized units option

Proposed Change:

- 9.1. In lieu of providing 20% of units at affordable prices, allow projects to provide affordable units comprising 20% of the Gross Residential Floor Area in the project provided that at least 50% of those units are in 2 or 3 bedroom units.

Background and Analysis:

Berkeley’s IHR and AHMF ordinances currently require that on-site BMR affordable units be of the same type and size as market rate units in the property. As the cost of construction has risen, there has been a trend for market rate projects to include smaller and smaller

apartments and this has meant that the BMR units have been shrinking as well. Some stakeholders have asked the City to consider ways to incentivize more ‘family sized’ units even in buildings where the market rate units are quite small. This request has been made at the same time that other stakeholders have called for the City to actively discourage units with high bedroom counts (i.e., co-living units).

It seems that in the current context the City should be encouraging 2 and 3-bedroom units but not larger ones. One way to achieve this is to require that projects set aside a given percentage of floor area for affordable housing instead of a percentage of units if the majority of those units are 2 and 3-bedroom units.

When New York City adopted their Mandatory Inclusionary policy for the first time in 2016, rather than requiring a percentage of units be affordable, they required that the affordable units make up a percentage of net residential floor area.⁹ This allows developers to include larger or smaller affordable units. Projects offering smaller BMR units may need to provide more units and projects offering larger units would provide fewer units. Cambridge, MA, a city with size and demographic similarities to Berkeley, also switched to this method in 2017, but with the additional condition that large developments (30,000 square feet or more) are required to include 3-bedroom affordable units.¹⁰ Both of these approaches would add considerable complexity to already complex rules in Berkeley. The proposed change would continue to require 20% of units for most Berkeley projects, but would add an alternative for projects that chose to offer mostly 2 and 3 bedroom BMR units.

10. Simplify the requirements for condominium conversions

Proposed Changes:

- 10.1. Calculate the Condo conversion fee at 8% of the market value of converted units.
- 10.2. Reduce the conversion fee to 4% for any unit that is and has been occupied by an owner as his or her principal place of residence for at least 5 consecutive years immediately prior to the date that the fee is paid, including as a tenant in that unit immediately prior to ownership.
- 10.3. Also reduce the conversion fee to 4% for any co-housing unit, any unit that is part of a housing cooperative, or conversion undertaken by a nonprofit developer.
- 10.4. Continue to allow a further 25% discount in the fee if it is paid at the time of conversion rather than at the time of sale of condo units.
- 10.5. Add flexibility in the use of conversion fees. Allow up to 10% of conversion revenue to be used for Condominium Conversion program delivery and/or Housing Trust

⁹ New York City Mandatory Inclusionary Housing Program, <https://www1.nyc.gov/site/planning/plans/mih/mandatory-inclusionary-housing.page>

¹⁰ City of Cambridge Inclusionary Housing, <https://www.cambridgema.gov/CDD/housing/inclusionaryhousing>

Fund program and project monitoring and enforcement or related program administrative costs with the remaining 80% placed into the Housing Trust Fund.

Background and Analysis:

Berkeley's Condominium conversion ordinance (CCO) (Berkeley Municipal Code [BMC] Chapter 21.28 et seq.) requires payment of an Affordable Housing Mitigation Fee at the time that rental properties are converted to condominium ownership. Between 1992 and 2009 this mitigation fee recaptured essentially the entire difference in affordability that resulted from conversion. This had the effect of discouraging conversions. In 2005, the state Court of Appeal held that cities could not prohibit conversion of rental units to Tenants in Common ownership (TIC). Since then, the City has sought to encourage conversion of rental units to condominiums rather than TICs because of difficulties that can arise for people who invest in TIC properties. It has done so by imposing a de facto cap on the affordable housing mitigation fee charged for conversion to condominiums since 2009.

Nexus Fee Calculation: Under the current ordinance the AHMF for condo conversions is calculated through a complex 'nexus formula' that considers costs of ownership, rental and mortgage rates. Alternatively, owners can choose to pay 8% of the sales price (or 4% for 2-unit buildings) instead of the Nexus Fee if they agree to limit rent increases for any existing tenants. This alternative calculation generally results in much lower fees. As a result, the nexus-based fee method has been used very rarely. We recommend that all condominium conversions be subject to the 8%/4% fee, and that all sitting tenants be provided protections and an opportunity to purchase.

Examples:

Nexus Formula: Rental Costs = \$1,500 per month x 12 months/year = \$18,000 annually
Ownership Cost (including principal, interest, taxes, insurance, and homeowners' association dues) = \$2,700 per month x 12 = \$32,400
Assume a mortgage rate of 6.5 percent. Increased housing cost due to ownership conversion of the unit = \$32,400 - \$18,000 = \$14,400
Mitigation Fee = \$14,400/0.065 = \$221,538

Alternative Formula: Sale price for converted unit = \$400,000. If owner agrees to limit rents to existing or future tenants. Mitigation fee = 8% x \$400,000 = \$32,000.

Discount for Owner Occupants/Tenant Conversion: Currently, the condo conversion ordinance provides a 50% reduction in the fee to owners who have lived in their units for the 5 prior years. However, only owners who resided in their units on June 30, 2010 are currently eligible.

If the property contains three or more units, the affordable housing mitigation fee for a unit that is occupied by an owner as their principal place of residence for at least 5 consecutive years immediately prior to the date of sale, including as a tenant in that unit immediately prior to ownership, shall be reduced by 50 percent, but only if the owner owned and resided in the unit as of June 30, 2010.

A Council referral had proposed to extend the 50% reduction to tenants in addition to owners who have lived in a unit for at least 5 years prior to conversion so long as the building was 4 or fewer units.

If the property contains 4 units or fewer, the affordable housing mitigation fee for a unit that is and has been occupied by an owner as his or her principal place of residence for at least 5 consecutive years immediately prior to the date of conversion or sale, including as a tenant in that unit immediately prior to ownership, shall be reduced by 50 percent.

It is not clear why this tenant conversion benefit should be limited based on building size. The current ordinance is limited to properties with 3 or more units while the referral was limited to 4 or fewer units. The proposed change would apply to owner occupied or tenant purchased units in buildings of any size.

Although instances of condominium conversion by nonprofits, in co-housing projects, or in housing cooperatives are quite rare, it makes sense to extend the fee reduction to these cases as well.

Use of Fee Revenue: The current condo conversion ordinance does not allow any of the Mitigation Fee revenue to be used for program administration, but the program can be staff-intensive to implement. The AMHF and IHR Ordinances allow a portion of fee revenue to be used for program administrative staffing.

11. Prohibit on-site units for Group Living Accommodation (GLA)

Proposed Change:

- 11.1. Prohibit projects with an average of more than 3 bedrooms per unit from selecting the on-site option in order to reduce administrative burdens.
- 11.2. Adopt a local density bonus that enables these projects to access the benefits of the State Density Bonus in exchange for an increased in lieu fee instead of on-site units.

Background and Analysis:

Group Living Projects: It is challenging to regulate and monitor BMR units in co-living and group living projects where individuals generally lease bedrooms not apartments. It is difficult to find eligible households who can both qualify for and afford 4-bedroom or larger BMR units and the households that would most benefit from large BMR units might be less interested in living in a building that was primarily targeting students and young adults. Additionally, it is typical for groups of unrelated adults renting larger units together to change composition frequently, which makes maintaining current documentation of eligibility more complicated for owners and therefore compliance more difficult for the City to monitor.

Local Density Bonus: Berkeley cannot prevent developers from providing on-site affordable units in order to qualify for the benefits of the State Density Bonus (SDB). It would be possible for the City to simply require some projects to pay the full fee even if they provide on-site units for the purpose of accessing the density bonus but this would impact the feasibility of small projects and projects that provide large bedroom count units. An alternative would be for the City to adopt a limited local density bonus program for these projects that are not allowed to provide on-site units under the City's ordinance. This local bonus could provide access to all of the benefits of the State Density Bonus (including additional density and other planning concessions) in exchange for a fee rather than on site units. We calculated that, for a typical rental project, providing 11% (of base units) on-site increases the cost of compliance relative to paying the fee only by \$10 per square-foot. If a local density bonus offered the benefits of 35% increased density and other concessions to projects that paid \$55 per square-foot (instead of \$45) this option would be no more or less attractive to developers than the current State Density Bonus option. In other words, if a co-living project could access the density bonus in exchange for a fee of \$55 per square-foot they would generally choose that option rather than provide on-site units.

12. Change requirements for small projects/missing middle projects

Proposed Changes:

- 12.1. Eliminate exemption for 1-4 unit projects and replace it with a tiered fee that steps up gradually for projects with less than 12,000 gross residential square feet, by reducing the fee by \$2 per square-foot for each 1000 square foot increment less than 12,000.
- 12.2. Offer a local density bonus, equal to the State Density Bonus, to projects providing <5 BMR units that choose the in lieu fee.

Alternative:

- 12.3. Eliminate exemption for 1-4 unit projects and expect even very small projects to contribute the full fee.

Background and Analysis:

Currently both the AHMF and the Inclusionary housing ordinance exempt buildings with 1-4 units. Presumably this exemption was motivated by a sense that very small projects would have a harder time absorbing the cost of including affordable housing into their budgets. While this is often, but not always true, there is no reason to think that suddenly at 5 units a project budget can easily afford to comply. There is a much wider range of "missing middle"-type projects that may be feasible in Berkeley at a small scale which may also struggle to meet the City's requirements. Many of these projects may be larger than 5 units.

At the same time there has been significant concern in Berkeley about the potential that developers may segment larger projects into several smaller 4-unit projects in order to circumvent the inclusionary housing or AHMF ordinance. By exempting very small projects but

then suddenly imposing the full requirement at a certain point, the current ordinance creates an incentive to build projects in 4-unit increments.

One approach to this challenge would be to impose the fee (at some level) on every project (with the exception of Accessory Dwelling Units), but to reduce the fee for small projects. Many cities just impose a lower fee for smaller projects. San Jose just amended their program to set the fee at a level that is 50% lower for projects with fewer than 20 units. However, this approach still creates a big step up at 20 units. An alternative is to gradually phase in higher fees as the size of the project increases. Figure 10 shows the schedule that would result from a \$2 decrease in the fee for each increment of 1000 gross residential square feet below 12,000.

Figure 10: Proposed schedule for small project phase-in

Gross Residential Square Feet	Fee per square-foot
12,000+	\$45
11,000-11,999	\$43
10,000-10,000	\$41
9,000-9,999	\$39
8,000-8,999	\$37
7,000-7,999	\$35
6,000-6,999	\$33
5,000-5,999	\$31
4,000-4,999	\$29
3,000-3,999	\$27
2,000-2,999	\$25
1,000-1,999	\$23
<1,000	\$21

Reducing the fee for small projects would have an uncertain impact on Berkeley’s future fee revenue. The City would collect less revenue from small projects with at least 5 units, but would begin collecting fees from 1 to 4 unit projects. Offering a local density bonus to projects providing less than 5 BMR units that choose the in lieu fee would likely reduce the number of projects with a small number of on-site BMR units that need to be monitored while also increasing total fee revenue.

Small projects pose a special challenge for program administration and monitoring. Monitoring compliance for a building with one or two regulated units requires a similar investment of staff time as a project with 20 BMR units. Often the owners of smaller buildings have fewer resources and less outside professional property management support and as a result, they often find the burdens of compliance more challenging, and require relatively more intervention and training from City staff.

Many cities address this by encouraging developers of small properties to select the fee or other option rather than providing on-site BMR units which may prove difficult to monitor.

Redwood City prohibits the on-site units option for projects with fewer than 20 total units, effectively requiring these projects to pay the in lieu fee.

In Berkeley, however, because so many projects select mixed-compliance, there is a real risk that projects with more than 20 total units could end up including only a very small number of on-site BMR units. For example a 40 unit project selecting on-site compliance (20%) would provide 8 BMR units but if they chose to only provide 10% on-site and pay a fee for the remainder they would only provide 4 BMR units on-site. Removing the on-site option for projects that would result in fewer than 5 BMR units would force these projects to either pay the fee entirely or fully comply through the on-site option. Either option would simplify monitoring enormously.

13. Cap the annual rate of rent increases

Proposed Change:

13.1. Limit the annual increase in BMR affordable rents for occupied units to no more than the annual change in the Consumer Price Index. Allow rents to be marked up to the maximum 'affordable' rents based on HUD AMI calculations whenever units turn over.

Alternative:

13.2. Limit the annual rent increase to no more than 10% in any single year.

Background and Analysis:

Sudden increases in the Area Median Income can result in large changes in the allowable affordable rent which can negatively impact BMR tenants. Similarly, some property owners fail to annually adjust rents as allowed by the current ordinance. They are allowed to 'catch up' by raising the rents by a larger amount later but this too can cause sudden shocks in rent for vulnerable tenants.

Limiting the amount that rent can be increased for occupied BMR units would provide stability and predictability for tenants. This change, however, will have a real impact on the operating budgets of projects with on-site BMR units. The current rules tie rents to changes in the Area Median Income (AMI). Over the past several decades the AMI has risen quite a bit faster than the Consumer Price Index. While the AMI is generally a measure of what people in the area earn, the rapid increase in the AMI has been driven, in part, by the growth of high paying jobs and the influx of higher income residents throughout the Bay Area rather than a rise in the wages and other income that lower-income residents earn. As a result, 'affordable' rents have risen faster than what many low-income tenants can comfortably 'afford.'

Limiting the rate of rent increases will have a real impact on the operating budgets of buildings that include on-site units. As long as units remain occupied, the rents may rise

more slowly than building operating costs. It is likely that this change in policy will make the on-site option slightly less attractive to developers and increase the likelihood of projects selecting to pay the fee in lieu. However, a growing number of Berkeley projects are including on-site VLI units and then filling those units with residents who hold housing vouchers. The policy should continue to allow these properties to collect the full voucher payment standard which might increase faster than CPI without impacting affordability for the residents. This reliance on vouchers should mean that many density bonus projects would not be impacted by a rule tying rent increases to CPI.

14. Administrative changes

a. Require compliance plans

Proposed Change:

14.1. Require developers of new projects to submit a simple Affordable Housing Compliance Plan at the time of Building Permit application indicating their proposed strategy for complying with the requirements of the AHR ordinance. Allow revisions to this plan at any time prior to the Certificate of Occupancy.

Background and Analysis:

Currently developers can wait until their projects are built and applying for a Certificate of Occupancy to inform the City of their intended strategy for complying with the AHMF or Inclusionary Housing Ordinance, including whether they intend to pay the fee or provide some or all of the required on-site units. Requiring developers to indicate a proposed strategy earlier in the process a) allows city staff to make plans for monitoring units or project fee revenue so that it can be invested quickly and b) ensures that developers are fully understanding Berkeley's requirements early in the development. Many cities provide a simple fill in the blanks template for this purpose and allow projects to change their plans at a later date by simply submitting a revised plan.

b. Authorize administrative citations

Proposed Change:

14.2. Explicitly authorize the creation of a proposed schedule of fines for monitoring and compliance violations to be included in the program guidelines.

Background and Analysis:

Other jurisdictions have found that having the ability to impose monetary fines is an effective tool for encouraging developer and property manager compliance with

monitoring requirements. Explicitly authorizing citations in the ordinance might help clarify staff's authority to impose these penalties.

c. Authorize annual monitoring fee for ownership units

Proposed Change:

14.3. Explicitly authorize the City to charge a fee annually to BMR Homeowners to offset monitoring costs. The fee would be assessed only on new owners going forward. The fee would be included as a housing cost in calculation of the affordable sales prices so that buyers will pay less for their units in order to make the fee affordable.

Background and Analysis:

The City currently charges owners of rental properties an annual monitoring fee but no fee is charged to BMR homeowners.

d. Deduct required fees/costs from gross rent

Proposed Change:

14.4. Clarify this language in the ordinance to make it clear that mandatory fees or costs must be deducted from the maximum allowable rent for BMR rental units.

Background and Analysis:

Currently the AHMF ordinance calls for reduction in the maximum rent based on the anticipated cost of tenant paid utilities. Some properties impose other mandatory costs such as renter's insurance or administrative fees. Current practice is to deduct any cost which is mandatory for BMR tenants from the maximum gross rent to calculate the affordable rent but this requirement is not currently outlined in the ordinance.

Appendix A: Financial Feasibility Analysis

Overview:

The City of Berkeley retained Street Level Advisors to recommend changes to its existing affordable housing requirements. Our policy recommendations are intended to increase the construction of affordable units while maintaining the financial feasibility of market-rate development. We conducted a financial feasibility study in order to understand the current housing development environment and predict how our recommended policies might affect this environment. Our study relies on a static pro forma analysis to estimate the return on investment that can be generated by typical residential developments in Berkeley.

For the rental prototype, we used a common measure of return known as yield on cost (YOC), or a project's net operating income divided by the total development cost. Based on a review of current market conditions in Berkeley and the East Bay, we concluded that projects earning a yield of at least 5.0% would be "feasible" meaning that they would likely be able to secure investment. Projects earning slightly less (between 4.5% and 5%) would be considered "marginal" meaning that some projects in this category might be able to obtain financing while others might not. Projects earning less than a 4.5% yield we considered "infeasible."

For ownership projects, the Yield on Cost cannot be calculated so we used a different measure of profitability: Profit as a percent of development cost, also called Return on Cost. Because of the lack of recent condo projects in Berkeley, we were unable to objectively determine the minimum necessary profit as a percent of cost for local ownership projects. As a point of reference, a common rule of thumb used in other studies considers projects "feasible" when profit exceeds 10-15% of development cost.

Our rental prototype is a 6-story, 72-unit development with a small amount of commercial space on the ground floor and one parking space for every two housing units. We estimate that under current conditions, rental projects that choose to pay Berkeley's Affordable Housing Mitigation Fee (AHMF) earn a Yield on Cost of 5.08% - just barely above the feasibility threshold. Projects that provide on-site units earn a yield of 4.94% just under the threshold into the marginal category. However, economic conditions are in flux due to the COVID-19 pandemic, and new projects could become more feasible in the near future.

Our prototype, revenue, and cost assumptions are based on prior studies, comparable projects, and other market research. The remainder of this memo describes these assumptions and our methodology in more detail.

Prior Studies:

Over the past decade, the City of Berkeley has evaluated the financial feasibility of its affordable housing requirements several times. Our analysis builds on the feasibility studies conducted by these consultants.

The 2015 Bay Area Economics Nexus Study contains one section that addresses the financial feasibility of new rental housing. BAE estimated the Return on Cost for a four-story, mixed-use development in the C-W zoning district at two different fee levels. In their simplified model, all 81 units are 900 square foot two-bedrooms. BAE's analysis suggested that the fee could be increased to \$34,000 while maintaining the minimum necessary return on cost.

The 2016 Strategic Economics Feasibility Analysis tested a wider range of fee levels. Using a four-story model that is almost identical to the BAE model, they estimated the Yield on Cost at six fee levels between \$0 and \$84,391. Strategic Economics considered Yield on Cost because it is a more accurate measure of feasibility for rental housing than Return on Cost. The minimum Yield on Cost required for feasibility in their analysis was 6.5% reflecting the higher interest rate environment in 2016. They found that new developments would be marginally feasible if the fee was \$45,000 and infeasible if the fee was any higher.

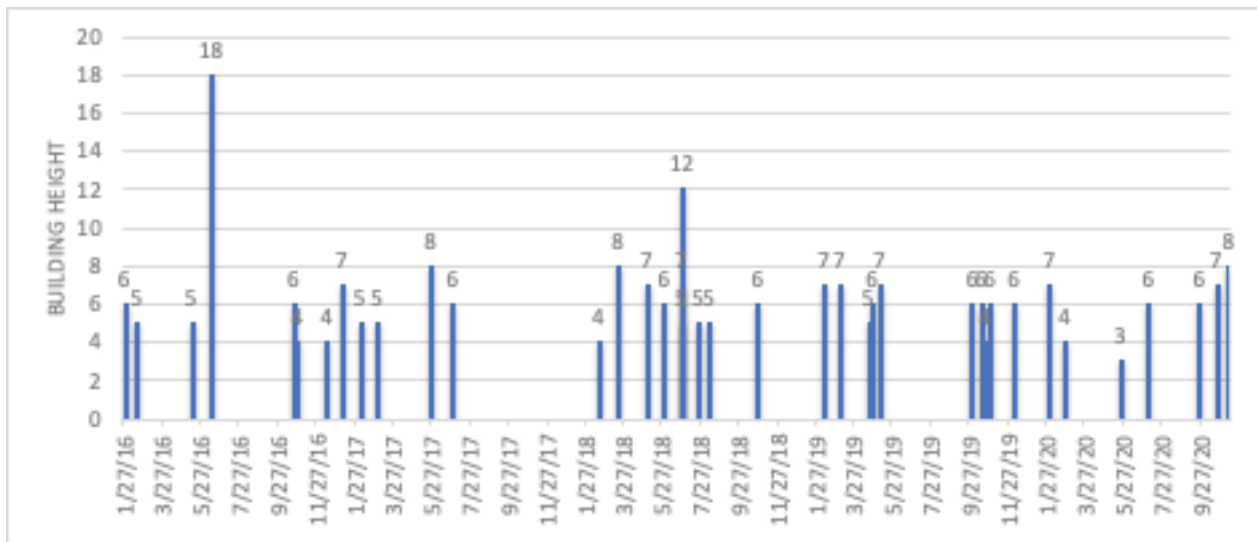
Together, the BAE and Strategic Economics analyses suggested that new rental development would be feasible at fee levels equivalent to and above the current level.

Prototypes Studied:

Rents and construction costs have escalated dramatically since the Strategic Economics analysis was published. Our recent data shows that rents are over 30% higher and the construction costs per square-foot in our model below are nearly double those in the Strategic Economics report. Our specific revenue and cost assumptions are described in the next section.

Because of these trends, the type of development project that both BAE and Strategic Economics used as their example would no longer be financially feasible in Berkeley. Driven by these same trends, the types of development projects being undertaken in Berkeley have shifted. Developers have responded to rising construction costs by building smaller units, fewer parking spaces and taller buildings on smaller lots. Figure 1 shows that developers of multi-family buildings in Berkeley have been primarily proposing 5-8 story buildings in recent years.

Figure 1: Permit applications for residential project with >20 units 2016 – 2020



Following these trends, we have used a slightly different prototype to test feasibility in today’s market. Our prototype is a 6-story building with wood frame residential over a concrete podium. Where BAE and Strategic Economics assumed a 1-acre lot, we have assumed a half-acre. Our prototype includes 72 housing units and 3,000 square feet of commercial space (see Figure 2). Our model is taller but contains fewer units and less commercial space than the 4-story, 81-unit Strategic Economics prototype. The units in our model are also smaller than the units in the Strategic Economics analysis. Based on a detailed study of recent projects in Berkeley we have assumed a mix of 450 square-foot studios, 725 square-foot one-bedrooms, and 925 square-foot two bedrooms where Strategic Economics had assumed that all units would be 900 square-foot two-bedrooms.

Recent data also suggests that the capitalization rate for residential development is 4.0-4.25%, significantly lower than the cap rate of 5.0% which Strategic Economics used in 2016. Additionally, the parking ratio of 1 space per unit in the Strategic Economics study reflects the minimum parking requirements in much of the city at the time their study was published. As parking minimums have recently been eliminated, we assume a more modest parking ratio of 0.5 spaces per unit, consistent with observed occupancy rates.

Figure 2: Rental Prototype Details

Prototype Feature	Value
Project	
Construction Type	Wood Frame over Concrete Podium
Stories	6
Site Area in Acres	0.5
Gross Sq Ft	68,950
Residential Sq Ft	52,750
Common Area Sq Ft	13,200
Commercial Space Sq Ft	3,000
Residential Units	
Number of Units	72
Number of Studios	14
Number of 1BD Units	36
Number of 2BD Units	22
Studio Sq Ft	450
1BD Sq Ft	725
2BD Sq Ft	925
Parking	
Parking Ratio (Spaces / Units)	0.5
Number of Spaces	36

For the ownership prototype, we assumed larger average unit sizes. In order to facilitate comparison, we assumed a building of the same overall size (square feet) but with fewer units of larger size. We also assumed the same parking ratio (.5) as our rental prototype in order to facilitate comparison, though it is more likely that a condo project would provide 1 space per unit which would lower overall returns.

Figure 3: Ownership Prototype Details

Prototype Feature	Value
Project	
Construction Type	Wood Frame over Concrete Podium
Stories	6
Site Area in Acres	0.5
Gross Sq Ft	61,490
Residential Sq Ft	52,290
Common Area Sq Ft	9,200
Commercial Space Sq Ft	0
Residential Units	
Number of Units	56
Number of 1BD Units	35
Number of 2BD Units	18
Number of 3BD Units	3
1BD Sq Ft	850
2BD Sq Ft	1,025
3BD Sq Ft	1,365
Parking	
Parking Ratio (Spaces / Units)	0.5
Number of Spaces	28

Revenue and Cost Assumptions:

The revenue and cost assumptions used in our pro forma analysis are shown in Figure 4. The main inputs that influence project revenue are the residential rents. Our analysis of data from CoStar, RealPage, and Berkeley's Rent Stabilization Board led us to estimate that typical rents for newly built apartments in Berkeley would be approximately \$3,100 for studios, \$4,000 for one-bedrooms, and \$4,500 for two-bedrooms. Other revenues include commercial rents of \$3 per square-foot and parking revenue of \$200 per space per month. These assumptions reflect rents that would have been assumed by projects prior to the pandemic. During the pandemic, rents throughout the region have fallen dramatically with some estimates showing rent in Berkeley down by 5 to 10% along with significant increases in apartment vacancy rates. The best available evidence suggests that these decreases are likely temporary. Developers in

Berkeley are moving forward on construction of new apartments which would not be financially feasible if the pandemic rents and vacancy rates were permanent.

The key input driving costs is the construction cost estimate of \$400 per gross square foot. This assumption is based on actual construction costs for comparable East Bay projects and studies that estimate the construction cost inflation rate. Other important development cost assumptions include land at \$8,000,000 per acre and parking construction costs at \$50,000 per space. We assume that soft costs - which include architecture, engineering, and inspection fees – equal 22% of hard costs. Our estimates for land, parking, and soft costs rely on data from several comparable Berkeley projects but, of course, these figures vary quite a bit between actual projects. Financing costs include the construction loan interest rate of 4.5% and the initial construction loan fee of 1.0%. Our financing cost assumptions are based on independent estimates of prevailing interest rates and data from comparable Berkeley projects.

The current inclusionary housing rules require that 80% of on-site VLI units be offered first to housing voucher holders. Berkeley allows developers to charge the full Housing Authority Payment Standard rent for these units even when it exceeds the rent that could be charged to a VLI tenant with no voucher. We have assumed these slightly higher rents for 80% of any VLI units on-site.

Note: The COVID-19 pandemic caused an uncommon economic crisis that the US is only beginning to recover from. It is unclear what persistent impacts the pandemic will have on the housing development environment and consequently on our model. We cannot be certain how inputs such as construction costs and rents will change or how investors that finance development will respond to this uncertainty. Over the past year construction costs have continued to rise while rents have fallen across the Bay Area. This combination has made it harder for real estate projects to achieve feasibility, but these trends do not appear to be lasting. Our model reflects conditions as they were at the beginning of 2020.

Figure 4: Revenue and Cost Assumptions

Revenue/Cost	Assumption	Unit of Measure
Residential Revenue		
Studio Rent	\$3,100	per unit per month
1BD Rent	\$4,000	per unit per month
2BD Rent	\$4,500	per unit per month
Ownership Revenues		
1BD Price	\$725,000	per unit
2BD Price	\$925,000	per unit
3BD Price	\$1,100,000	per unit
Other Revenues		
Commercial Rent	\$3.00	per sq ft per month
Parking Revenue	\$200	per space per month
Development Costs		
Construction Costs	\$400-\$415	per gross sq ft
Land Costs	\$8,000,000	per acre
Parking Costs	\$50,000	per space
Soft Costs	20-22%	of hard costs
Financing Costs		
Construction Loan Interest Rate	4.5%	annual rate
Loan to Cost Ratio	70%	of total cost
Period of Initial Loan	24	months
Initial Construction Loan Fee	1.0%	of loan
Average Outstanding Balance	60%	of loan
Operating Costs		
Rental Vacancy Rate	4%	of units unoccupied
Rental Operating Cost	35%	of revenues

Policy Scenarios:

We built a financial model using the project prototypes described above in order to test the impact of potential changes to the City's affordable housing requirements on the feasibility of

residential development. We ran the model for the same hypothetical projects under a number of different policy assumptions. First, we established the returns that would be available under the current law depending on which performance option the project selected.

Current Program Scenarios

Rental

Current Fee: Under this alternative, we assume the hypothetical project elects to pay Berkeley's current Affordable Housing Mitigation Fee (AHMF) of \$39,746 for each unit in the building. A project paying the fee would not be eligible for the density bonus.

Current On-site Units: Under this alternative, we imagine the project selecting instead to provide on-site units as provided under the current AMHF ordinance. The project would provide 7 Very Low Income (VLI) units (10%) and 7 Low Income (LI) units (10%). For the sake of comparison, we have assumed that the project does not access the density bonus though it would likely qualify.

Current Mixed Compliance – 11% VLI: The most common approach in recent years has been for projects to provide enough units on-site in order to maximize the benefits of the State Density Bonus and pay a fee to cover the remainder of their obligation under Berkeley's AHMF. Prior to 2021, projects that provided 11% of base units as restricted Very Low Income units on-site would receive the maximum 35% density bonus. We have assumed that our hypothetical project could increase the total number of housing units by 35% (from 79 to 97) with no increase in land costs¹¹.

Current Mixed Compliance – 15% VLI: In 2020 the State Legislature approved an expansion of the State Density Bonus which allows greater increases in density in exchange for more affordable housing units on-site. Now a developer can request a 50% increase in residential density if they provide, for example, at least 15% Very Low Income units. We have analyzed the profitability of a hypothetical

¹¹ Our analysis does not attempt to capture the full financial value of the density bonus. In addition to the right to build more housing units on a given site, state law allows developers to request a number of planning concessions based on the amount of affordable housing that they provide. These concessions clearly provide real value which can increase the profitability of projects. However, because the dollar value of concessions is abstract and highly dependent on the particular project, we have not attempted to include this in our financial modeling. As a result, our conclusions are likely to slightly understate the difference between the returns from density bonus and other types of projects.

project assuming a 50% increase in units with 15% of base units (10% of total units) restricted to VLI residents under current rules.

Ownership

Current On-site Compliance: A for-sale project that elected to provide on-site affordable units would be required to provide 20% of units to be affordable to and occupied by Low Income households earning less than 80% of AMI.

Current In Lieu Fee (Based on Sales Prices): Alternatively, a developer may pay an in lieu fee calculated based on 62.5% of the difference between the market price and the affordable price. This approach results in a different level of fee for different projects depending on the market prices of units in the project. For the sake of illustration, we estimated a range of current market prices based on average condo sales prices listed on Zillow.com and calculated the fee which would be due.

Figure 5: Condo Pricing Assumptions

Estimated BMR Ownership Fees 2021						
Unit Size	Sq Ft	Estimated Market Price	Affordable Price	In Lieu Fee	In Lieu Fee Per Unit	In Lieu Fee per Sq Ft
1BR	814	\$703,556	\$250,650	\$283,066	\$56,613	\$70
2BR	1117	\$853,125	\$282,000	\$356,953	\$71,391	\$64
3BR	1571	\$995,797	\$313,200	\$426,623	\$85,325	\$54

Alternative Policy Options

In addition to evaluating the performance of the prototype under the current policy rules, we considered several alternative scenarios based on the proposed policy changes.

Rental

\$45 Per square-foot Fee: Under this alternative, we assumed that the City adopted a fee of \$45 per gross square foot (excluding parking and commercial space) and we evaluated the returns for a prototype project that elected to pay this fee in full with no on-site BMR units.

\$55 Per square-foot Fee: This alternative assumes full payment of a higher fee per square-foot.

Mixed Compliance (Weighted)– 11% VLI: In this alternative we have assumed a \$45 per square-foot fee is adopted along with an adjusted formula for determining the remainder fee for mixed compliance projects. We assumed that each 1% of VLI units provided would reduce the fee due by \$3 per square-foot and each 1% of LI units would reduce the fee by \$1.50 per square-foot. In this alternative, we assume a project that provides 11% of the base units (equivalent to 8% of total units) as VLI in order to receive a 35% density bonus.

Mixed Compliance (Weighted)– 15% VLI: In this alternative we assume a project that provides 15% of the base units (equivalent to 10% of total units) as VLI in order to receive a 50% density bonus under state law. As with the scenario above, this alternative assumes that the formula for calculating the remaining fee for mixed compliance provides greater reductions for projects that provide VLI units.

Ownership

\$45 Per Square-foot Fee: In this scenario, we have assumed that the City adopts a single per square-foot rate of \$45 which would be applied to all projects whether rental or ownership.

\$55 Per Square-Foot Fee: This alternative assumes that the City adopts a higher per square-foot fee for ownership projects (or any project that records a condominium map).

Findings:

For rental projects, our model suggests that most projects would not be able to feasibly comply with the current 20% on-site requirement but that projects that choose to pay the fee or access the State Density Bonus by providing some units on-site and paying a partial fee would both earn returns that are just barely above the threshold which we identified for feasibility (5% yield on cost). The returns for density bonus projects are comparable to the fee alternative because the additional cost of providing some units on-site is offset by the additional benefit of building more units on the same site.

For this prototype, the proposed fee of \$45 per gross square foot results in a virtually identical return. A higher fee (\$55 per square-foot) would result in a marginal but very close to feasible

return. The proposed approach of providing more ‘credit’ for projects that provide on-site VLI units than those that provide LI units results in modest increases in the returns available to mixed compliance projects that take advantage of the State Density Bonus. While this small difference is not critical for this prototype, it is likely that there would be projects where this difference would result in on-site affordable units in projects that would otherwise have paid the fee entirely (or not moved forward at all).

Figure 6: Comparison of Returns - Rental

Scenario	Base Units	Bonus Units	LI Units	VLI Units	Fee \$	Yield on Cost	% of Base	% of Total
Current Policy								
\$39,746 Per Unit Fee	72	0	0	0	\$2,861,712	5.08%	0%	0%
Onsite Units	72	0	7	7	\$0	4.94%	19%	19%
Mixed Compliance - 11% VLI	72	25	0	8	\$2,265,522	5.07%	11%	8%
Mixed Compliance - 15% VLI	72	36	0	11	\$2,106,538	5.10%	15%	10%
Proposed Alternatives								
\$45 Per Foot Fee	72	0	0	0	\$2,967,750	5.07%	0%	0%
\$55 Per Foot Fee	72	0	0	0	\$3,627,250	4.99%	0%	0%
Mixed Compliance (Weighted) - 11% VLI	72	25	0	8	\$2,350,809	5.10%	11%	8%
Mixed Compliance (Weighted) - 15% VLI	72	36	0	11	\$2,184,925	5.12%	15%	10%

For ownership projects, we found that neither the current fee nor the current on-site requirement resulted in profit as a percent of development cost above the benchmark of 10%. The proposed switch to a \$45 per square-foot fee would result in profit just above 10% while a higher \$55 per square-foot fee would result in profit closer to 9%.

Figure 7: Comparison of Returns - Ownership

Scenario	Total Units	LI Units	Fee \$	Profit % of Cost
Current Policy				
Current Fee (based on sale prices)	56	0	\$3,810,847	8.00%
Onsite Units	56	11	\$0	1.13%
Proposed Alternatives				
\$45 Per Foot Fee	56	0	\$2,767,050	10.88%
\$55 Per Foot Fee	56	0	\$3,381,950	9.16%

Sensitivity Analysis:

Revenues and Costs: The feasibility projections above are highly sensitive to assumptions about rents and construction costs. These assumptions are different from one project to the next and change in somewhat unpredictable ways over time. The heat table in Figure 8 below shows the

yields on cost that our model predicts for a range of different scenarios in regard to construction costs and rents for our prototype. This table shows returns for a 6-story rental project that selects the proposed \$45 per square-foot fee option. The axes indicate how these scenarios compare with current construction cost and rent levels. The (0%, 0%) cell in the center of the table represents the estimated yield on cost for projects given today’s rents and construction costs. The (-10%, 10%) cell in the top right represents the yield for projects if rents decrease 10% and construction costs increase 10% relative to current levels. Green cells represent situations in which projects will be feasible, with expected yields on cost at or above 5%. The redder a cell is, the less feasible projects will be. A rise in construction costs will increase the total development cost of a project, making it less feasible. A drop in market rents will decrease the rental income a project can expect, also making it less feasible.

Figure 8: Yield on Cost Sensitivity to Rents and Construction Costs

		Construction Costs										
		-10%	-8%	-6%	-4%	-2%	0%	2%	4%	6%	8%	10%
Rents	-10%	5.07%	4.96%	4.85%	4.75%	4.65%	4.56%	4.47%	4.38%	4.30%	4.22%	4.14%
	-8%	5.18%	5.07%	4.96%	4.85%	4.76%	4.66%	4.57%	4.48%	4.40%	4.32%	4.24%
	-6%	5.29%	5.18%	5.07%	4.96%	4.86%	4.76%	4.67%	4.58%	4.49%	4.41%	4.33%
	-4%	5.40%	5.29%	5.17%	5.07%	4.96%	4.86%	4.77%	4.68%	4.59%	4.50%	4.42%
	-2%	5.52%	5.40%	5.28%	5.17%	5.07%	4.96%	4.87%	4.77%	4.68%	4.60%	4.51%
	0%	5.63%	5.51%	5.39%	5.28%	5.17%	5.07%	4.97%	4.87%	4.78%	4.69%	4.61%
	2%	5.74%	5.62%	5.50%	5.38%	5.27%	5.17%	5.07%	4.97%	4.87%	4.78%	4.70%
	4%	5.85%	5.73%	5.60%	5.49%	5.38%	5.27%	5.17%	5.07%	4.97%	4.88%	4.79%
	6%	5.97%	5.84%	5.71%	5.59%	5.48%	5.37%	5.26%	5.16%	5.07%	4.97%	4.88%
	8%	6.08%	5.95%	5.82%	5.70%	5.58%	5.47%	5.36%	5.26%	5.16%	5.07%	4.97%
	10%	6.19%	6.06%	5.93%	5.80%	5.69%	5.57%	5.46%	5.36%	5.26%	5.16%	5.07%

With current rents and construction costs, projects are just barely feasible with estimated yields of 5.07%. However, if rents rise by just 2% and construction costs remain flat, projects will become more feasible with expected yields of 5.17%. As expected, yields increase as rents rise and decrease as construction costs rise. Yield on cost is just slightly more sensitive to construction costs than rents. Construction costs falling by 10% will increase yields a bit more than rents rising by 10%.

Parking: The feasibility of new rental development in Berkeley is also highly sensitive to assumptions about the amount of parking provided. The parking ratio is the number of parking spaces divided by the number of residential units. Before 2021, Berkeley’s zoning regulations mandated projects in some districts to have parking ratios of at least 1. Berkeley recently eliminated minimum parking requirements, making parking ratios of 0 possible.

Figure 9 shows the yields on cost that our model predicts for a range of parking scenarios. In our model, parking ratios are used to describe the amount of parking provided by a project. Creating parking spaces is expensive and limits the area available for the project’s residential or amenity space. As a result, higher parking ratios reduce a project’s yield on cost and projected feasibility. Our model predicts that projects that provide no parking will be solidly financially feasible while projects that provide 1 space per unit are not currently feasible.

Figure 9: Yield on Cost Sensitivity to the Parking Ratio

Parking Ratio				
0.00	0.25	0.50	0.75	1.00
5.34%	5.20%	5.07%	4.94%	4.82%

Even with strong financial incentives and no City parking requirements, most projects are likely to include significant amounts of parking. Depending on the location of the project, tenants may see parking as a necessary building amenity. In other cases, project investors insist on some level of parking. When Seattle eliminated parking requirements in many parts of the city, [one study](#) found that most projects still included parking. In areas with no parking requirement, nearly 30% of new buildings provided no parking after the mandate was removed. But the remaining 70% provided parking even though it was not required by the city. Figure 10 shows that the average project provided .49 parking spaces per unit.

Figure 10: Seattle parking reform results

Minimum Number of Required Parking Spaces/Unit	Number of Development Projects	Average Parking Ratio	Buildings That Exactly Met Requirement	Buildings That Provide Parking Above Requirement		
				<0.5 Spaces/Unit	0.5-1.0 Spaces/Unit	>1.0 Spaces/Unit
0	570 (65.6%)	0.49	29.5%	24.2%	39.0%	7.4%

Attachment 4: Summary of Council Referrals Related to City Affordable Housing Requirements

Referral	Short Description
Conducting an Analysis of Increasing Inclusionary Housing over Affordable Housing Mitigation Fee (9/10/19)	A companion to 4/23/19 referral to analyze feasibility of ideas from Homeless Commission including: -Requiring on-site units instead of a fee -Requiring an increased number of inclusionary units -Providing an incentive to build on-site instead or pay the fee (similar to the Adeline Corridor Specific Plan) -Prohibit payment of fee in certain geographic areas -Ensure access for extremely low-income persons and persons experiencing homelessness.
Refer to the City Manager and the Housing Advisory Commission to Consider Reforming the Affordable Housing Mitigation Fee (4/23/19)	Evaluate the possibility of changing the City's affordable housing fee structure, including converting the current per-unit calculation to a per-square foot fee, per-bedroom fees and/or whether to apply a different fee methodology in different parts of the city.
Affordable Housing Mitigation Fee Resolution to Close a Loophole for Avoiding the Mitigation Fee through Property Line Manipulation (2/19/19)	Close a loophole allowing avoidance of the affordable housing fees through lot line manipulation by requiring the fee from projects on contiguous lots under common ownership with the potential for 5 or more units across all lots. Modify the structure of the in lieu fee for ownership projects to a flat per unit fee similar to the rental fee. Evaluate the appropriateness of the fee level.
Encourage Long Term Tenant Stability (11/27/18)	Modify the Berkeley Municipal Code (BMC Section 21.28.080) to allow tenants buying their units (through Tenancy-In-Common) to pay only 50% of the Affordable Housing Mitigation Fee at the time of conversion. This is the same benefit offered to owners who convert rental buildings that they also live in to ownership.
Rectify Discrepancy Regarding Inclusionary Units in Live/Work Housing (9/13/2018)	Eliminate the affordable housing requirements in the Berkeley Municipal Code (BMC Sections 23C.12 and 23E.20.080) and instead apply the Inclusionary Housing or AHMF ordinances to Live Work exactly as they are applied to other projects.
Pilot Density Bonus Program for the Telegraph Avenue Commercial District to Generate Revenue to House the Homeless and Extremely Low-Income Individuals (5/30/17)	Create a new City Density Bonus policy for the Telegraph Avenue Commercial District to generate in-lieu fees instead of on-site affordable housing units.

To read the reports from which these referrals derived, please visit the City of Berkeley's Records Online page, at <https://records.cityofberkeley.info/PublicAccess/paFiles/cqFiles/index.html> . For Search Type select "Public – Staff Report Query," for Meeting Body select "City Council," and for Doc Date put the date of the referral formatted MM/DD/YYYY (e.g. 09/10/2019). Other fields may be left blank. Click "Search" and the requested document should come up as one of a handful of listed results.

For further assistance searching Records Online, please contact the City Clerk Department at clerk@cityofberkeley.info.

**NOTICE OF PUBLIC HEARING
BERKELEY CITY COUNCIL**

AMENDMENTS TO BMC CHAPTER 23.328 UPDATING THE CITYWIDE AFFORDABLE HOUSING REQUIREMENTS IN THE ZONING ORDINANCE; REPEAL OF BMC SECTIONS 22.20.065, AND SECTION 23.312.040(A)(6); AND A RESOLUTION ADOPTING REGULATIONS FOR VOUCHER PROGRAM AND ESTABLISHING AN IN-LIEU FEE PURSUANT TO BMC SECTION 23.328.020(A)(2) AND RESCINDING RESOLUTION NO. 65,074-N.S.

The public may participate in this hearing by remote video or in-person.

The Department of Planning and Development and Planning Commission of the City of Berkeley is proposing amendments to BMC Chapter 23.328, updating the citywide affordable housing requirements in the Zoning Ordinance; repeal of BMC Sections 22.20.065, and Section 23.312.040(A)(6); and a Resolution Adopting Regulations for Voucher Program and Establishing an In-Lieu Fee Pursuant to BMC Section 23.328.020(A)(2) and Rescinding Resolution No. 65,074-N.S.

Pursuant to CEQA Guidelines Section 15378(a) and 15060(c)(2), environmental review is not required because the proposed amendments do not meet the definition of a Project under CEQA Guidelines Section 15378(a), nor does it constitute an activity covered by CEQA under CEQA Guidelines Section 15060(c)(2) because passage of amendments do not constitute a direct physical impact on the environment, nor would it result in an indirect, reasonably foreseeable physical impact on the environment. The proposed amendments do not include any provisions that would exempt or otherwise reduce environmental review required under CEQA for individual development projects.

The hearing will be held on, **Tuesday, January 17, 2023 at 6:00 p.m.** at the Berkeley Unified School District Board Room located at 1231 Addison Street, Berkeley CA 94702.

A copy of the agenda material for this hearing will be available on the City's website at www.berkeleyca.gov as of **January 5, 2023**. **Once posted, the agenda for this meeting will include a link for public participation using Zoom video technology, as well as any health and safety requirements for in-person attendance.**

For further information, please contact **Alisa Shen, Principal Planner** at (510) 981-7409.

Written comments should be mailed or delivered directly to the City Clerk, 2180 Milvia Street, Berkeley, CA 94704, in order to ensure delivery to all Councilmembers and inclusion in the agenda packet.

Communications to the Berkeley City Council are public record and will become part of the City's electronic records, which are accessible through the City's website. **Please note: e-mail addresses, names, addresses, and other contact information are not required, but if included in any communication to the City Council, will become part of the public record.** If you do not want your e-mail address or any other contact information to be made public, you may deliver communications via U.S. Postal Service or in person to the City Clerk. If you do not want your contact information included in the public record, please do not include that information in your communication. Please contact the City Clerk at 981-6900 or clerk@cityofberkeley.info for further information.

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Per California Government Code Sections 65856(a) and 65090, and 6062(a).

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I hereby certify that the Notice for this Public Hearing of the Berkeley City Council was posted at the display case located near the walkway in front of the Maudelle Shirek Building, 2134 Martin Luther King Jr. Way, as well as on the City's website, on January 5, 2023.

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Mark Numainville, City Clerk