



# City of Morgan Hill

## Legislation Text

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### **CITY COUNCIL STAFF REPORT MEETING DATE: DECEMBER 14, 2016**

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APPROVED BY: City Manager

### **BELOW MARKET RATE (BMR) HOUSING IN-LIEU FEE RECOMMENDATIONS**

#### **RECOMMENDATION(S)**

1. Receive the Keyser Marston & Associates (KMA) Report entitled "Draft Analysis of Morgan Hill's BMR Program," dated November 29, 2016;
2. Provide direction to staff to return with an Ordinance that:
  - A. Institutes a \$12.92 housing in-lieu fee (based on 8% affordability provision), per square foot of livable space of the entire project, effective with the FY 2019/20 Residential Development Control System (RDCS) competition year;
  - B. Maintains the existing .5 fractional threshold for payment of fee vs. providing the unit on site; and
3. Institute a below market rate (BMR) minimum size.

#### **COUNCIL PRIORITIES, GOALS & STRATEGIES:**

##### **Ongoing Priorities**

Maintaining fiscal responsibility

##### **2016 Focus Areas**

Planning Our Community

Participating in Regional Issues **REPORT NARRATIVE:**

The City retained KMA to conduct an analysis of the impact of the City's RDCS (BMR) requirements, and to:

1. Estimate the financial cost to developers of providing on-site BMR units;
2. A comparison of the cost of providing on-site BMR units to the RDCS program's in-lieu fee and, if appropriate, recommend changes to the in-lieu fee amount so that it more closely approximates the cost of providing on-site units in today's market; and
3. Recommend program changes that will provide long term support for administration of the City's BMR program.

The first draft report "Analysis of the Impact of the Below Market Rate (BMR) requirements of the City's Residential Development Control System (RDCS) on Development Economics" dated March

28, 2016 (Attachment B) was provided to City Council on June 22, 2016, and included a preliminary analysis of the cost of providing on-site BMR units relative to the City's current housing in-lieu fee (\$150,000) per unit delivered. It provided initial recommendations that allowed us to facilitate a conversation to work towards more closely aligning the Housing In-lieu fee with the actual cost of providing on-site units in today's market and to obtain input from the development community.

The most recent KMA report "Draft Analysis Of Select Attributes of Morgan Hill's BMR Program" dated November 29, 2016 (Attachment A) was informed by the following series of workshops and discussions held regarding the BMR Program and the Housing In-lieu fee:

- City Council BMR Workshop I, May 18, 2016
- BMR Ordinance, City Council Meeting, June 1, 2016
- KMA Housing In-lieu fee workshop with the Development community, June 15, 2016
- KMA Housing In-lieu fee discussion with City Council, June 22, 2016
- Second KMA Housing In-lieu fee workshop with the Development community, November, 1, 2016

Based on input received during these sessions, KMA and City Teammates conducted an additional review of the eight residential developments in the City that served as prototypes for this analysis, ranging in product type, density, lot size, price point, and unit size. In addition, a review of the recorded maps for projects with BMR units was undertaken to understand the location of BMR units within City projects, the square footage size of BMR units relative to the size of market rate units, and to further refine the analysis.

KMA compared Morgan Hill's RDCS "standard" \$150,000 in lieu fee (\$12,000 per unit impact per door), and "double" \$300,000 fee structure (\$24,000 per unit impact per door) to the fees charged by other cities, using the eight prototypes as case studies, and converted the existing per unit fee to an amount per square foot of building area. On a per square foot basis, Morgan Hill's current maximum "double" fee of \$24,000 per unit translates into a current fee ranging from \$8.40 per square foot (Esperanza project) to \$12.75 per square foot (Loden project). The "standard" fee amount of \$12,000 per unit translates into a current fee of \$4.20 per square foot (Esperanza) to \$6.37 per square foot (Loden). Whether or not the City receives a standard or double housing in-lieu housing fee is based on how the applicant commits to earn points through its initial menu of RDCS options. Based on the review of the case study projects and KMA's analysis described in the report, the Housing Team is suggesting the following recommendations:

### **1. Minimum Size of BMR Units**

It is recommend that the City require that the BMR units be no smaller than either:

- a) the smallest market rate plan in the project or,
- b) when the project has larger units, and the smallest market rate unit is over 2,500 square feet, BMR units can be no less than the lesser of: 1) 75% of the average size of the market rate units in a project; or 2) 1,900 square feet, a 24% difference, (conditioned living space; not including garage). The maximum bedroom count for BMR units shall be 4 bedrooms.

Under this provision, if the developer chooses to have the BMR units be equivalent in size to the smallest market rate plan, then the bedroom count of the BMR units cannot exceed the bedroom count of the comparable market rate unit. The BMR development standards currently only specify that BMR units must be at a minimum "equal in size to the smallest market rate unit." While most of the BMR units within the projects that we reviewed were generally equal in size to the smallest market rate plan, there are some cases in which the BMR units are significantly smaller than any of the market rate units with additional bedrooms to achieve a higher restricted sale price, encouraging tight quarters.

Bedrooms should be designed to accommodate two persons and have at least 120 square feet of useful living space in addition to adequate closet space. There should be an adequate number of bathrooms for the expected household sizes. Three and four bedroom units must have at least two full bathrooms. Other unit types (studio, one-bedroom, and two-bedroom units) shall have the same number of bathrooms as the market rate units). BMR units should be provided proportionately in the same unit type mix (number of bedrooms) as the market rate units. In consideration of the household size of the households on the current program interest list, the City and developer may negotiate to provide a greater proportion of a particular unit type. There shall not be significant identifiable differences between the BMR and market-rate units visible from the exterior. The design of the BMR units must be reasonably consistent with the market-rate units in the development.

## 2. *In-Lieu Fee*

When an applicant chooses to pay the housing in-lieu fee, it is recommended that the basis for the in-lieu fee be changed from a "per unit" fee to a \$12.92 "per square foot" fee of total livable space. This recommendation is based on KMA's analysis of the eight case studies, whereby they estimated the foregone profit to the developer associated with providing on-site affordable units and converted the foregone profit or "cost" to an amount per square foot of building area. This change makes the fee more equitable, and accounts for the differences in unit sizes across projects.

**Example:** Project has 56 total units, average size of market rate units is 2,000 square feet. To receive maximum RDCS points:

On site obligation = 56 total units X 8% affordable commitment = 4.48 BMR units.

In lieu fee = 56 units X 2,000 square feet X **\$12.92** per SF = \$1,447,000.

## 3. *Fractional Fee*

It is recommended that the fractional BMR fee be increased from the current level which translates into a fraction of \$150,000 per BMR unit owed to an amount that is equivalent to the proposed per BMR unit in-lieu fee amount based on per square foot.

**Example:** Project has 56 total units, average size of market rate units is 2,000 square feet. To receive maximum RDCS points:

Obligation = 56 total units X 8% affordable commitment = 4 on-site BMR units + Fractional Fee for .48 units

Implicit in lieu fee = 56 units X 2,000 square feet X **\$12.92** per SF = \$1,447,000

Implicit fee per BMR unit = \$1,447,000 / 4.48 units = \$322,991 per BMR unit owed

Fractional fee owed = .48 X \$322,991 = \$155,000.

4. Note: KMA also recommended that the fractional threshold be increased from .5 to .8. The current program applies the fractional fee to fractional requirements less than 0.5 of a unit. The recommended increase would increase the amount of housing fee revenue generated by the RDCS program, which may be a consideration for City Council in the future to support the City's Housing Program. However, at this time Staff is not recommending an increase to the fractional threshold to support Council's previous feedback in which it indicated the desire to continue to see an incentive to build the BMR units, hence, maintaining the existing .5 thresholds to encourage the construction of BMR units.

Lastly, but importantly, this report translates to funds and affordable housing requirements in the current RDCS process. A new RDCS workbook and scoring mechanism is being discussed due to the passage of Measure S. This workbook and the related competition points are being discussed in public meetings with the Planning Commission, with its recommendations ultimately forwarded to the City Council for review and acceptance. The new workbook will need to be complete for the implementation of a newly authorized RDCS ballot measure by March 1, 2017.

**COMMUNITY ENGAGEMENT:           Involve**

The following workshops and meetings were held:

- City Council BMR Program Workshop I, May 18, 2016
- BMR Ordinance, City Council Meeting, June 1, 2016
- KMA Housing In-lieu fee workshop with the Development community, June 15, 2016
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**ALTERNATIVE ACTIONS:**

The Council can choose not to approve any one of the recommendations at this time and/or direct staff to return at a later date.

**PRIOR CITY COUNCIL AND COMMISSION ACTIONS:**

The City Council adopted a BMR Ordinance, June 1, 2016, and held a KMA Housing In-lieu fee discussion at the City Council, June 22, 2016 meeting at which they directed staff to continue further refining the in-lieu fee analysis.

**FISCAL AND RESOURCE IMPACT:**

None at this time. Future impacts will be analyzed upon final adoption of an ordinance and a resolution.

**CEQA (California Environmental Quality Act):**

Not a Project

**LINKS/ATTACHMENTS:**

1. Attachment A\_KMA Draft Report, November 29, 2016
2. Attachment B\_KMA Draft Report, March 28, 2016
3. KMA Presentation

