

bae urban economics

March 28, 2023

George Rodericks
City Manager
Town of Atherton
80 Fair Oaks Lane
Atherton, CA 94027

Re: Residential Inclusionary and In-Lieu Fee Nexus and Financial Feasibility Analysis

Dear Mr. Rodericks:

We appreciate the opportunity to submit this proposal to conduct a financial feasibility and nexus analysis to evaluate the Town's inclusionary ordinance and associated in-lieu fees. We understand that the Town is in the process of implementing an inclusionary ordinance that would require 20 percent of units in new residential developments to be affordable to low- or moderate-income households, with the option to pay an in-lieu fee in some circumstances. The Town is seeking technical analyses to support the implementation of the inclusionary ordinance that will include:

- **Financial feasibility analysis to evaluate the feasibility of the 20 percent inclusionary requirement** (Task 2 in the following proposed scope of work). This component of the analysis will respond to requirements put in place by California Assembly Bill (AB) 1505 (2017) that provide the California Department of Housing and Community Development (HCD) with the authority to review economic feasibility studies related to rental inclusionary ordinances. A local government may be required to submit an economic feasibility study if: a) its ordinance has rental inclusionary requirements that require more than 15 percent of the total number of units to be affordable to households with 80 percent of AMI or less and b) the jurisdiction has failed to meet at least 75 percent of its above-moderate income RHNA over at least a five-year period.

While AB 1505 does not require an economic feasibility study for inclusionary requirements on ownership projects, BAE is proposing to evaluate the financial feasibility of both the rental and for-sale inclusionary requirements. BAE recommends this approach because this analysis will estimate the cost associated with providing affordable units in accordance with the inclusionary ordinance, which will feed into the analysis of in-lieu fees (see below).

- **Financial analysis to evaluate in-lieu fees** (Task 3 in the following proposed scope of work). This component of the analysis will evaluate in-lieu fees that would apply to developments that choose to opt out of providing affordable units by paying an in-lieu fee. AB 1505 requires that inclusionary ordinances provide at least one alternative to providing inclusionary units on site within market-rate developments, and many

jurisdictions offer an in-lieu fee as an alternative. BAE understands that the intent of the Town of Atherton's ordinance is to incentivize developers to provide inclusionary units on-site rather than paying the in-lieu fee, though some development projects (e.g., the construction of a single single-family home) are anticipated to pay in-lieu fees rather than providing units, and the Town may choose to offer an in-lieu fee alternative for all projects. BAE will work with Town staff to identify policy objectives related to in-lieu fee. To the extent that the Town wants to incentivize developers to provide inclusionary units on-site within market-rate developments rather than pay an in-lieu fee, the analysis will identify fee rates that will generally incentivize on-site production of affordable units. This portion of the analysis will evaluate in-lieu fees for both rental and ownership developments, and for both multifamily and single-family developments.

- **Nexus analysis to evaluate the relationship between new market-rate residential development and the need for affordable housing and in-lieu fees** (Task 4 in the following proposed scope of work). This component of the analysis will quantify the estimated relationship between new market-rate residential development and the need for affordable housing. This analysis can help to provide a policy basis for implementing inclusionary requirements, as it demonstrates that the market-rate units in a residential development lead to a need for additional affordable units. The nexus analysis will also quantify the estimated fee that the Town of Atherton would need to charge to address the affordable housing need that is attributable to new market-rate development, which can help to provide a policy basis for charging the in-lieu fee. BAE anticipates that this analysis will evaluate ownership and rental developments as well as both single-family and multifamily developments.

In BAE's experience, this type of nexus analysis often results in a fee amount that is higher than most jurisdictions choose to charge, and is higher than needed to incentivize developers to provide affordable units rather than paying the fee. As a result, local jurisdictions tend to adopt in-lieu fees that are lower than the maximum justifiable fee identified in the nexus analysis, with the adopted fee rates based on financial feasibility or other policy considerations.

BAE is an award-winning real estate economics and development advisory firm with a distinguished record of achievement over its 30+-year history. We have extensive experience conducting affordable housing fee and inclusionary housing nexus analyses, including for the Cities of Sunnyvale, Windsor, Los Angeles, Ventura, and Berkeley in California as well as for the Cities of Moab, Utah and Dallas, Texas. These studies have included detailed analyses of the impacts of new development on the need for affordable housing, the cost to provide that housing, and the resulting maximum justifiable fee amounts. BAE's nexus study work has also included extensive financial feasibility analysis to evaluate the impact of fees on new development, comparisons of proposed fees to the fees charged peer jurisdictions, and recommendations on revised fee rates. These studies have also included one-on-one

developer interviews and stakeholder focus groups to obtain input on key assumptions and potential fee and policy changes.

In addition to financial feasibility analyses as part of our nexus study work, BAE also has deep expertise in financial feasibility analysis to assist public agencies in making key decisions related to inclusionary housing and other key housing policy decisions. Within the past five years, BAE's projects have included financial feasibility analyses to evaluate inclusionary requirements and in-lieu fees for the Cities of Menlo Park, South San Francisco, Napa, Santa Barbara, and Los Angeles. For each study, BAE created a series of financial feasibility models that allowed the local jurisdiction to understand current conditions and evaluate key policy decisions.

The following pages detail our proposed work program, schedule, and budget. We would be happy to work with City staff to adjust this scope of work to meet the City's needs for this analysis. Please feel free to contact me at stephaniehagar@bae1.com or 510.326.8943 if you have any questions or would like to further discuss this proposal.

Sincerely,

A handwritten signature in black ink, appearing to read 'Stephanie Hagar', with a stylized flourish at the end.

Stephanie Hagar
Principal

SCOPE OF SERVICES

This section outlines BAE's proposed work program.

Task 1: Project Start-Up

BAE will hold a project start-up meeting with Town staff to review the scope of work, proposed timeline, proposed inclusionary requirements, and background materials for review, as well as to discuss overall project objectives. BAE will prepare a data and information request and draft schedule for discussion during the start-up meeting. As a part of this task, BAE will also review any relevant background materials relating to the proposed inclusionary housing ordinance, inclusionary in-lieu fee, and potential future typologies in Atherton, along with any other relevant materials.

Task 2: Inclusionary Feasibility Analysis

BAE will conduct a financial feasibility analysis to evaluate the economic feasibility of the Town's proposed inclusionary requirements. This task will consist of the following subtasks:

2.1. Define Residential Prototypes. BAE will work with Town staff to define up to four (4) residential development prototypes for feasibility testing. BAE anticipates that the prototypes will include both rental and for-sale developments, as well as both single-family and multifamily developments, that will reflect the zoning on sites where each type of developments could be built in Atherton. To the extent appropriate, one or more of these prototypes may incorporate a density bonus and/or other waivers and concessions pursuant to the State Density Bonus ordinance.

2.2. Financial Pro Forma Models. BAE will create a financial pro forma model for each of the residential prototypes defined in Task 2.1 above. To inform the financial feasibility analysis, BAE will contact developers that are familiar with the local development context to discuss development costs, rents and sale prices, required return thresholds, and other factors that affect the financial feasibility of new residential development. BAE will also use information from BAE's other recent studies to supplement and cross-check information obtained through developer interviews. The pro formas will include affordable units in accordance with the inclusionary requirements that the Town is currently considering. Based on this analysis, the pro formas will determine whether the requirements that the Town is currently considering are economically feasible. The pro formas will also estimate the cost of providing inclusionary units on site in new residential developments, which will inform the analysis in Task 3.

Task 3: In-Lieu Fee Financial Feasibility Analysis

In this task, BAE will conduct a financial feasibility analysis to evaluate potential in-lieu fees that would apply to projects that choose to pay an in-lieu fee rather than provide affordable units on site within a market-rate project, to the extent that the Town allows an in-lieu fee

option. Because the intent of the Town of Atherton's ordinance is to generally incentivize developers to provide inclusionary units on-site rather than paying the in-lieu fee, BAE's proposed approach to this analysis will focus on identifying fee rates that will tend to be somewhat less attractive to a developer compared to providing inclusionary units within a project. This task will consist of the following subtasks:

3.1. Define Residential Prototypes. BAE will work with Town staff to define up to four (4) residential development prototypes for feasibility testing. BAE anticipates that the prototypes will include both rental and for-sale developments and both single-family and multifamily developments that will be analogous to the prototypes defined in Task 2.1. However, the prototypes from Task 2.1 may need to be adjusted if the prototypes in Task 2.1 include density bonuses or waivers or concessions pursuant to the State Density Bonus ordinance, since the Density Bonus would not apply in situations in which a developer pays an in-lieu fee.

3.2. Financial Pro Forma Models. BAE will create a financial pro forma model for each of the residential prototypes defined in Task 3.1 above. This task will use information obtained during the developer interviews conducted in Task 2.2 as well as information from BAE's other recent studies to develop key assumptions for the financial feasibility models. The analysis will estimate the in-lieu fee rates that are similar in cost to providing affordable units on site, as determined in Task 2, for each development typology. This will enable the Town to identify fees that are somewhat higher than the cost of providing affordable units on site, if desired to incentivize developers to provide units within new developments rather than paying the in-lieu fee.

Task 4: Residential In-Lieu Fee Nexus Analysis

BAE will conduct a nexus analysis that demonstrates the relationship between new market-rate residential development, the need for affordable housing, and the affordable housing in-lieu fees that are necessary to mitigate the associated affordable housing need. The nexus analysis is based on the concept that new households in market-rate units in Atherton spend money in the local economy, thereby helping to support new local jobs and bringing new workers to the region, including workers that will need affordable housing. This worker affordable housing need is associated with a need for fee revenue to construct the housing needed for these workers.

The nexus analysis will estimate household spending by households in new market-rate units in Atherton, the number of new workers by industry category that are attributable to that spending, and the household income distribution among these new workers. This will include the use of IMPLAN software to estimate household spending and associated jobs, and data from the US Census Public Use Microdata Sample (PUMS) to estimate household income among new workers. The analysis will then identify the number of new below market rate housing units, by income level, that would be needed to mitigate the demand for affordable

housing among these workers. The analysis will then evaluate the public subsidy necessary to construct these affordable units, which will constitute the maximum nexus-based in-lieu fee for new residential development. This methodology provides a basis for establishing in-lieu fees that are proportional to the impact of new market-rate development. The budget for this task assumes BAE will conduct analysis for up to four residential development typologies (e.g., multifamily rental, condominium, townhome, and single-family).

Task 5: Draft and Final Report

BAE will prepare a report that clearly describes the methodology and findings from the financial feasibility and nexus analyses. BAE will prepare an administrative draft report for review by Town staff. Upon submittal of the draft report, BAE will be available for a virtual meeting with Town staff to provide an overview of the report and respond to questions. Following receipt of one set of consolidated comments from the Town, BAE will revise the draft report and produce a final draft.

Task 6: Public Meetings

BAE will attend up to three public meetings (e.g., one Planning Commission meeting and two City Council Meetings) to present the study, respond to questions, and receive comments and input. BAE will prepare presentation materials for meetings as necessary and will review all presentation materials with Town staff prior to meetings to obtain input and make refinements. BAE will attend all public meetings virtually.

PROPOSED BUDGET

BAE will bill for the work described above for a fixed-fee budget of \$97,200, as shown in the budget provided below. This total does not include the cost of any public meetings, which could be added to the total budget at an additional cost. The budget shown below will include all consultant costs, including personnel, overhead, and miscellaneous reimbursable expenses. Miscellaneous expenses such as data purchase are passed through to the client with no markup. BAE reserves the right to re-allocate budget among authorized tasks to best serve project needs; however, in no event shall the total cost exceed the fixed-fee amount unless the City requests additional work beyond the agreed-upon scope.

<u>Task</u>	<u>Budget</u>
Task 1: Project Start-Up	\$2,500
Task 2: Inclusionary Feasibility Analysis	\$27,400
Task 3: In-Lieu Fee Financial Analysis	\$12,700
Task 4: In-Lieu Fee Nexus Analysis	\$25,600
Task 5: Draft and Final Report	\$19,800
Task 6: Public Meetings	\$7,200
Labor Subtotal	\$95,200
Expenses (IMPLAN & other data)	\$2,000
Project Total, Excl. Optional Tasks	\$97,200

Costs for any additional work authorized by the client will be billed on an hourly time-and-materials basis, in accordance with BAE's standard hourly billing rates:

Principal	\$300-\$330/hour
Associate Principal	\$285/hour
Director	\$275/hour
Vice President	\$245/hour
Senior Associate	\$210/hour
Associate	\$170/hour
Sr. Analyst	\$130/hour
Analyst	\$115/hour

These rates are subject to revision on or after January 1, 2024.

PROPOSED SCHEDULE

BAE will complete an administrative draft memorandum within three months following project start up. Within two weeks of receiving a single set of consolidated written comments on the administrative draft, BAE will prepare the final report.