

Residential Feasibility Analysis & In-Lieu Fee Recommendations

December 2024

Health, Housing, & Community Services
Planning & Development

Strategic Economics
Street Level Advisors



Agenda

Introductions

Background

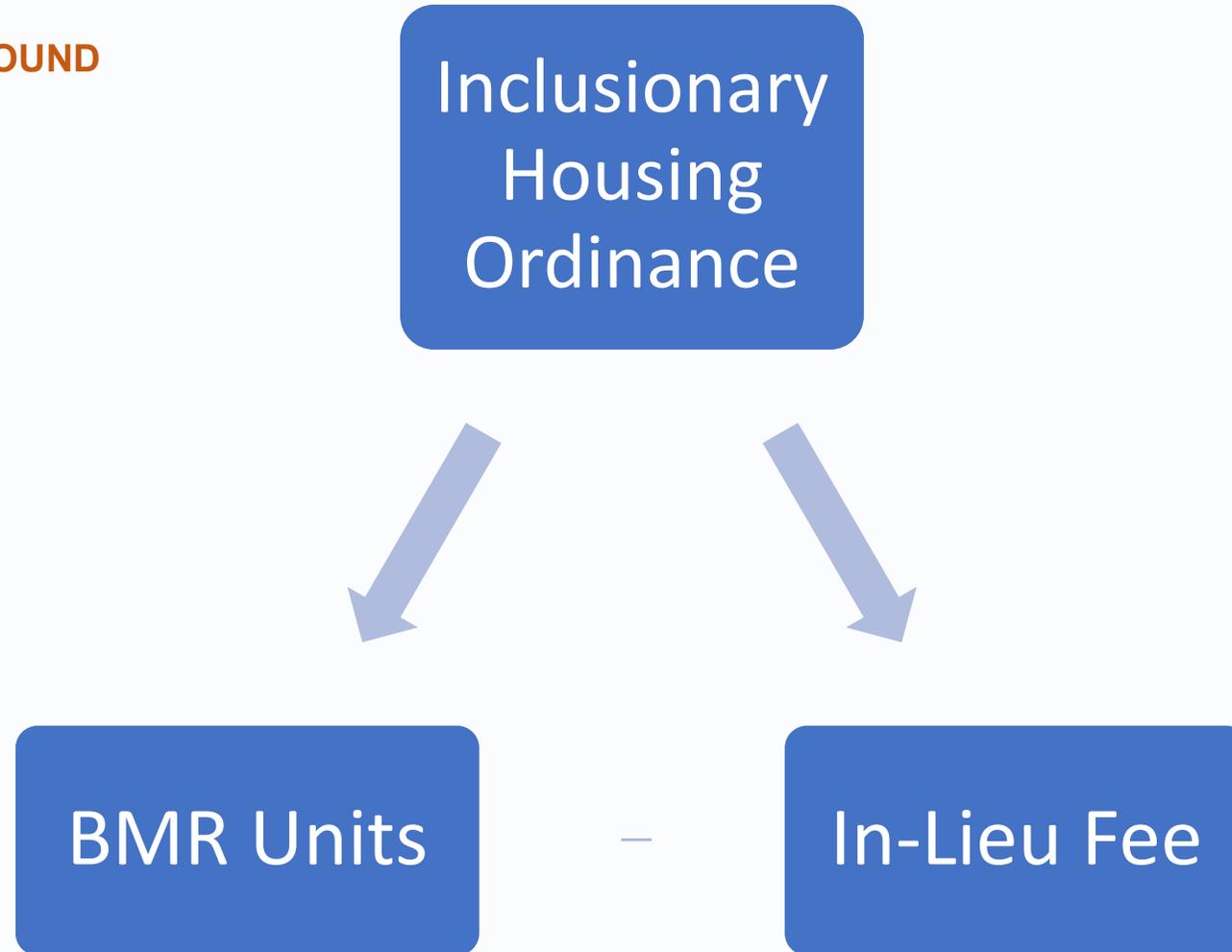
Goals

Findings & Recommendations

Next Steps

Questions and Comments

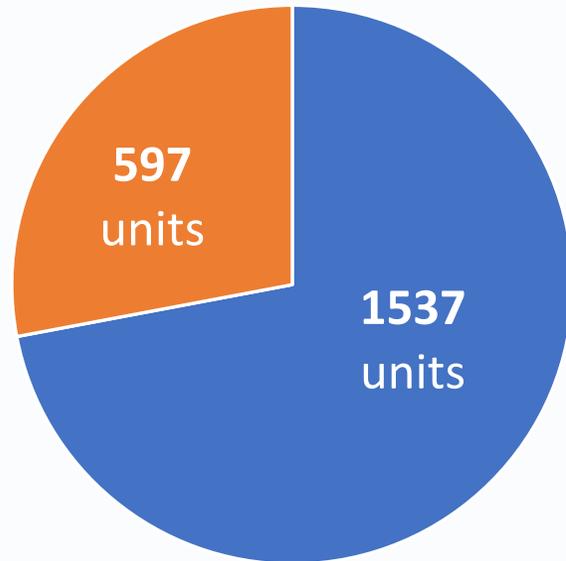
BACKGROUND



BACKGROUND

Berkeley's Affordable Housing Portfolio

Affordable Housing by Type



- Subsidized Units (HTF)
- Unsubsidized Units (BMR)

Housing Trust Fund Sources

- In-Lieu Fee
- Measure P
- Measure U1
- Measure O

BACKGROUND

IHO Revisions

- Feb 2023: Adoption of IHO & direction to conduct study
- Ownership and rental fees coordination
- Square footage In-Lieu Fee (RUFA)
- Covid/Inflation consideration
- Tiered fee + 5,000 sq ft exemption

BACKGROUND & REVIEW

Purpose of Study

- **Analyze the In-Lieu Fee**
- **Recommend fee levels & policy options**
- **Incorporate HARD HATS, Bird Safe Building impacts**

BACKGROUND & REVIEW

Policy Goals

Continue producing affordable housing

Support the financial feasibility of the housing market

Offer flexibility

Promote Middle Housing product types



Study Methodology, Findings, and Recommendations

Methodology

We used three approaches to evaluate maximum reasonable in-lieu fee levels

Affordability Gap:

the capitalized difference in revenues between a market and BMR* unit

Production Cost Affordability Gap:

the difference between capitalized value of BMR unit revenue and the cost to produce a unit of income-restricted housing

Average Local Contribution:

the average City of Berkeley contribution to 100 percent affordable projects

*BMR = below market rate; i.e., a deed-restricted affordable housing unit

Prepared 7 development prototypes to test financial feasibility considerations

- Prototypes are hypothetical developments used to test financial feasibility
- Based on recent and proposed developments in Berkeley
- External sources informed Missing Middle prototypes
 - “Missing middle” refers solely to building type/density for this study’s purposes
- Prototypes vary by:
 - Height
 - Tenure
 - Density
 - Parking ratio/format
 - Use of State Density Bonus Law

Mid and high-rise prototypes

	4-Story GLA	6-Story Midrise	8-Story Midrise	18-Story High-rise
Example				
Description	Micro-studio units with shared common spaces	Podium style midrise	Podium style midrise	Type 1 high-rise
Floors	4	6	8	18
Housing Units	36	75	120	240
Density (unit/acre)	180	150	240	480
Tenure	Rental	Rental	Rental	Rental
Uses Density Bonus	Yes	Yes	Yes	Yes

Source: Strategic Economics, 2024.

Missing Middle prototypes

	Small Lot Single Family	Fourplex/ Townhomes	10-Unit Small Multifamily*
Example			
Description	Multiple single-family homes on a standard single family lot size	Stacked townhomes on a standard single family lot size	3-story multiplex with surface parking
Common Location	West Berkeley	West Berkeley	n/a
Floors	3	3	3
Housing Units	3	4	10
Density (units/acre)	30	40	50
Tenure	Rental & Owner	Rental & Owner	Rental & Owner
Uses Density Bonus	No	No	No

Note: This prototype draws from Opticos' Missing Middle design guidelines, since it is a development type not commonly seen in Berkeley.
 Source: Strategic Economics, 2024.

The prototypes were tested in a financial feasibility analysis

- Determines if a project generates sufficient revenues to justify the costs and risks of building
- Represents perspective of a developer considering site acquisition and construction of a housing project

Components of Financial Feasibility: Project Value and Project Cost



Source: Strategic Economics, 2024.

Feasibility results are a snapshot of current conditions; development conditions change

- All aspects of project costs, revenues, and required return change over time
- Most factors are outside the control of the City
- Feasibility analyses need to be conducted regularly

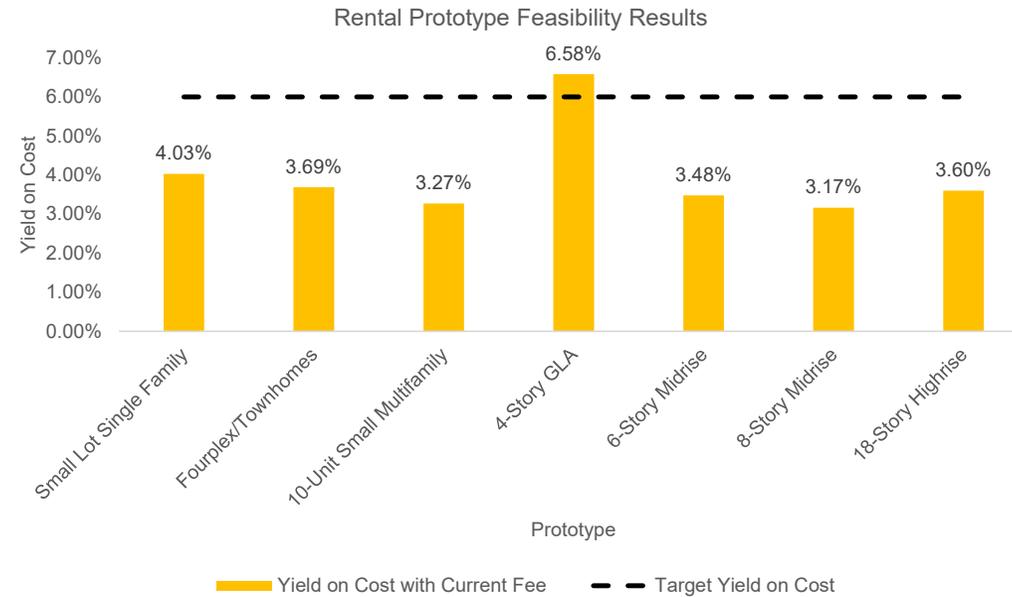
Cost and Revenue Change Impacts on the Return on Cost of One Ownership Unit						
		Change in Sales Value				
		-10%	-5%	0%	5%	10%
Change in Development Costs	-10%	29.16%	36.33%	43.51%	50.69%	57.86%
	-5%	22.36%	29.16%	35.96%	42.76%	49.55%
	0%	16.24%	22.70%	29.16%	35.62%	42.08%
	5%	10.71%	16.86%	23.01%	29.16%	35.31%
	10%	5.68%	11.55%	17.42%	23.29%	29.16%
	15%	1.08%	6.70%	12.31%	17.93%	23.54%

Source: Strategic Economics, 2024.

Findings

Current development conditions limit the rental prototypes' feasibility

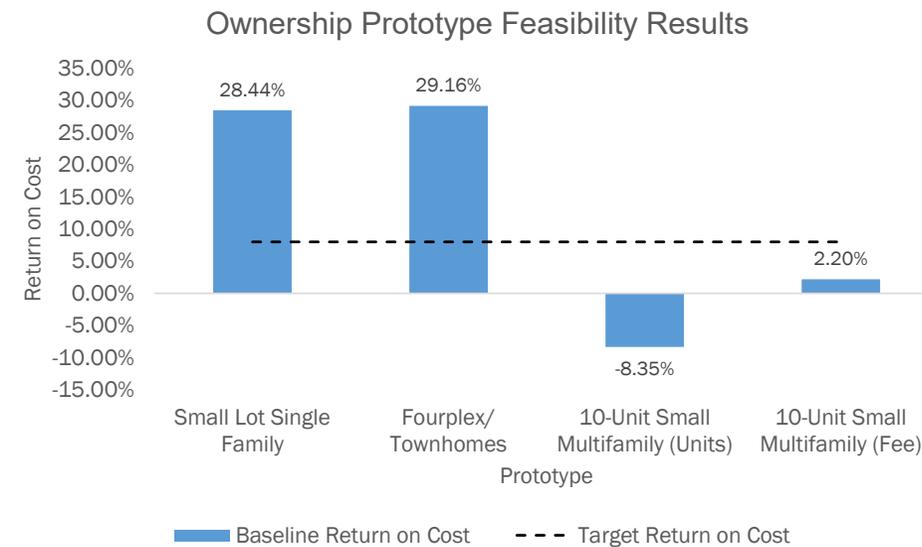
- Only the 4-Story GLA is feasible in current development conditions and under the current in-lieu fee



Source: Strategic Economics, 2024.

Some *ownership* Missing Middle products are currently feasible, but face other challenges

- Feasible:
 - Small Lot Single Family
 - Fourplex/Townhomes
- Feasibility supported by high sales prices as a luxury ownership product
 - BUT, challenged by limited site opportunities and pool of developers pursuing small projects
- Infeasible:
 - 10-Unit Small Multifamily



Source: Strategic Economics, 2024.

Maximum reasonable in-lieu fees range from \$59 to \$118 per square foot

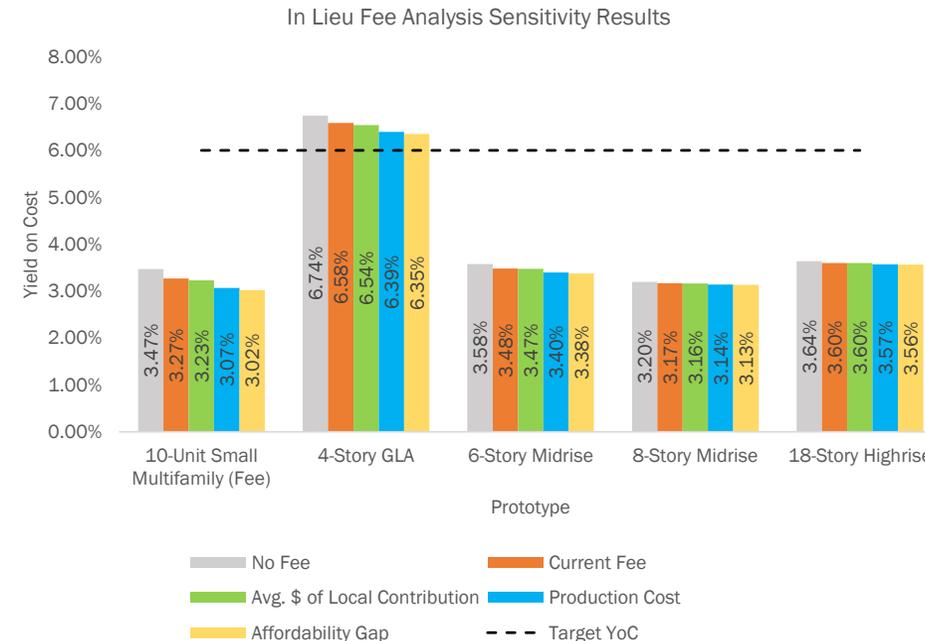
- Affordability gap: comparable to cost of meeting inclusionary requirement
- Production cost affordability gap: cost gap to produce an affordable unit
- Local contribution: average City contribution to produce an affordable unit

In Lieu Fee Results by Approach			
	Affordability Gap	Production Cost	Local Contribution
Average per Unit	\$388,374	\$342,432	\$193,348
Average per Square Foot of Market Rate Project RUFA	\$117.69	\$103.77	\$58.59

Source: Strategic Economics, 2024.

Market conditions limit feasibility for most residential prototypes, regardless of fee level

- All but the GLA prototype are infeasible even without the fee
- Infeasibility driven by elevated construction & financing costs and slower rent growth
- The impact of the in-lieu fee is low for Density Bonus projects
 - Fee is only charged to non-bonus square footage
 - Fee is prorated for remaining obligation above the mandatory on-site BMR units



Source: Strategic Economics, 2024.

Considerations for adjusting the in-lieu fee level / policy

- Most of the tested prototypes are currently infeasible
 - Most prototypes cannot support current in-lieu fees
 - BUT, in-lieu fees are not the primary driver of feasibility challenges
 - Some projects still developed due to unique circumstances
- In-lieu fees are a critical source of affordable housing funding
- Developments that pay the full fee—typically smaller and Missing Middle projects—are more sensitive to changes in fee level
- Most larger projects pay a prorated fee to satisfy remaining inclusionary requirements; these projects provide on-site BMR units to receive State Density Bonus

Study Recommendations

Apply the same in-lieu fee to all residential development projects

- Change the current exemption for projects under 5,000 square feet, to an exemption of the first 5,000 feet of *every* project that pays the full fee
- Eliminate the phased in fee for projects between 5,001-12,000 sf
- Apply the same in-lieu fee at the current maximum level (\$56.25) to all new residential developments

Exempt the first 5,000 sf of RUFA for projects paying full in lieu fee

- This exemption supports the production of Missing Middle housing, as these project types are less likely to be providing on-site units to gain access to the Density Bonus
- This reduces the fee per square foot of project area for these development types
- Projects that select mixed-compliance, would pay a residual fee based on the full RUFA (no exemption)

Maintain the existing \$56.25 maximum fee level as the universally applicable fee

- While the fee could justifiably be increased, maintaining the current maximum level supports the production of new housing by not increasing the fee when market conditions are challenging
- This fee level is approximately equivalent to the City's direct contributions to the cost of leveraging an off-site affordable housing unit
- Therefore, maintaining the fee at the current maximum allows the City to continue supporting off-site affordable developments

Continue to adjust the in-lieu fee based on the California Construction Cost Index

- Regular adjustment of the fee increases the likelihood that the revenue collected will continue to support a comparable number of affordable units in future 100 percent affordable housing projects.
- The in-lieu fee increases every two years since its last adoption in 2023; the next increase is proposed to still occur July 1, 2025

Include a provision in the resolution dedicating 80% of Very Low-Income Units for Section 8 and Shelter Plus Care voucher holders

- Resets the voucher distribution to the original level adopted under the AHMF ordinance
- Supports displaced households under the preference policy and non-voucher income qualifying households

Summary of Recommended Actions

BACKGROUND & REVIEW

Recommendations

Recommend the City Council take the following actions:

- Adopt a resolution setting the Inclusionary Housing In-Lieu fee at \$56.25 per square foot of the Residential Unit Floor Area (RUFA) of a Housing Development Project; and
- Include a provision in the resolution to allow a project paying the full In-Lieu fee instead of providing Affordable Units to deduct 5,000 square feet from the RUFA calculation; and
- Include a provision in the resolution dedicating 80% of Very Low-Income Units for Section 8 and Shelter Plus Care voucher holders
- Continue to adjust the fee biennially by the Construction Cost Index (CCI) starting on July 1, 2025; and
- Adopt an amendment to Berkeley Municipal Code (BMC) Chapter 23.328 to remove the exemption for projects with 5,000 square feet or less of RUFA

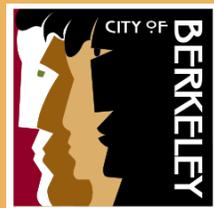
BACKGROUND & REVIEW

Next Steps

Questions and Comments

Planning Commission

Adopt Resolution/BMC Amendment



Questions

