Balanced Communities (Inclusionary Housing) Policy Study and In-Lieu Fee Analysis

CITY OF CHULA VISTA

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EXECUTIVE SUMMARY

RSG, Inc. ("RSG") prepared this Balanced Communities (Inclusionary Housing) Policy Study and In-Lieu Fee Analysis ("Analysis") for the City of Chula Vista ("City") to support the City's 2021-2029 Housing Element ("Housing Element") commitment to review the existing Balanced Communities Policy ("Policy") for feasibility in making progress towards the City's Low- and Moderate-income Regional Housing Needs Assessment ("RHNA") allocation. The Policy was adopted by the City Council in 1981 as part of the City's Housing Element for the purpose of increasing the diversity of housing prices and rents throughout the community and ensuring that a range of prices and rents continues over time. The Analysis also evaluates alternatives and modifications to the Policy that may better address City goals without undermining the feasibility of residential development.

In broad terms, the existing Policy requires 10% of total units in new residential developments to be restricted and made affordable to households with Low- and Moderate-incomes[1]. At least 5% of the units shall be designated for Low-income households and 5% of the units shall be designed for Moderate-income households. The Policy applies to all residential developments of 50 units or more. In addition to on-site unit production, the Policy can also be fulfilled by off-site unit production, public benefit, alternative housing types, and payment of an in-lieu housing fee. The in-lieu housing fee is currently set at $12,422 per unit and has not been changed since at least 2008.[2]

To evaluate the feasibility of the existing Policy and alternatives, RSG conducted a financial analysis of five different prototypical residential developments in Chula Vista. RSG considered the financial impact of inclusionary requirements under the Policy, as expressed by a generally equivalent in-lieu fee that a developer could pay as an alternative to providing affordable units on-site. RSG's key recommendations are outlined below:

- **On-Site Affordable Unit Production Requirement**: RSG recommends no change to the City's existing inclusionary requirement that 10% of total units in a project be restricted as affordable.
- **Income-Level Targeting**: RSG recommends no change to the existing income-level targeting of 50% of units for Low-income households and 50% for Moderate-income households.
- **Threshold Project Size Subject to Policy**: RSG recommends that all housing development, or at least those with 10 units or more, contribute to affordable housing

[1] California's Department of Housing and Community Development defines household income levels for affordable housing as "Very Low-", "Low-", and "Moderate-income" for households that earn less than 50, 80, or 120% of the area median income for San Diego County, respectively.

[2] City staff indicated that the in-lieu housing fee has not changed since 2008. However, City staff and RSG were unable to locate documentation of the original adoption of the $12,422 per unit in-lieu fee.

production through either the inclusion of affordable units, payment of a proportionate in-lieu fee, or some other equivalent alternative means of compliance.

- **In-Lieu Fee**: RSG recommends fees of $8 per square foot of market-rate for-sale housing, and $16 per square foot of market-rate rental housing. RSG also recommends revisiting the in-lieu fee on a periodic basis in response to changing market conditions to ensure it correlates to the actual projected cost of on-site affordable unit production and does not make development infeasible.

- **Ordinance and Resolution**: RSG recommends adopting the Policy by ordinance, and the in-lieu fee by resolution.

RSG completed the Balanced Communities Policy Study and In-Lieu Fee Analysis during the second and third quarter of 2023 and it is reflective of then-existing market conditions. At that time, some product types were marginally feasible due to higher interest rates, supply chain impacts on building material costs, and other market forces that were expected to subside. RSG's recommendations are designed for general Policy feasibility over the long-term. However, because market conditions will fluctuate, RSG recommends revisiting the Policy on a periodic basis, such as within five years or with each Housing Element update.

Report Organization

This Report contains six sections, as follows:

- Section 1 – Background: This section includes a summary of the current Policy, Chula Vista's housing needs, and the use of inclusionary housing programs to create affordable housing in California.
- Section 2 – Chula Vista Housing Market and Product Types: This section provides an overview of the residential market in and around the city, including prototypical types and sizes of housing units, rental rates and sale prices, development costs, and projected investment returns to developers.
- Section 3 – Affordable Housing Costs: This section examines the cost to produce affordable housing units in the City. This is determined by the "affordable funding gap", which is the difference between the development cost for different unit types and sizes and the amount which households of varying sizes and income levels can reasonably afford to purchase or rent.
- Section 4 – Policy Design Options and Best Practices: This section answers common questions about inclusionary housing programs and describes the range of program design options.
- Section 5 – Analysis of Affordable Unit Production Options and In-Lieu Fee Levels: This section details the calculations involved in determining a feasible production requirement, as well as appropriate in-lieu amounts.
- Section 6 – Conclusion and Policy Options: This section summarizes RSG's findings, alternative options, and recommendations for a revised Policy.

SECTION 1: BACKGROUND

Chula Vista's Existing Balanced Communities Policy

The following summarizes the requirements of the Policy, based on the "Guidelines to the Balanced Communities Policy", as revised September 13, 2022:

On-site Affordable Unit Production Requirement	10% of all units must be restricted as affordable.
Affordability Mix	At least 5% of units shall be designated for Low-income households, and 5% of the units shall be designated for Moderate-income households. Incentive Credit: At the developer's option, a developer may meet the inclusionary requirement by providing Very Low- or excess Low-income units. This is referred to as an Incentive Credit, and is calculated as follows: • 2.0 unit credit for every Very Low-income unit in-lieu of a Moderate-income unit; • 1.5 unit credit for every Low-income unit in-lieu of a Moderate-income unit; • 0.5 unit credit for every Very Low-income unit in lieu of a Low-income unit.
Affordability Term	For-rent units must be restricted for 55 years. For-sale units must be restricted for 45 years.
Development Subject to Policy	All new residential development of 50 units or more.
Exclusions	Development projects with less than 50 units.
Alternatives	• In-Lieu Housing Fee: Developers may choose to satisfy a portion of their inclusionary requirement through payment of an in-lieu fee, included a prorated in-lieu fee for partial units. The fee is approved by the City Council.

	• Off-Site Unit Production: Off-site unit production may include construction of new affordable units at a different site, acquiring and rehabilitating existing market rate units and conversion to affordable units, transfer of affordable housing credits from the City or other developer, or provision of housing projects or programs to meet the special needs of certain population groups within the community. • Public Benefit: The City may approve alternatives to the construction of new inclusionary units where the proposed alternative provides a more effective and feasible means of satisfying the requirements of greater public benefit. • Alternative Housing Types: When alternative housing types are developed and measured in terms of rooms or beds provided, rather than units, a conversion analysis from rooms or beds to units will be required to determine the unit credits a developer will receive.

Meeting Chula Vista's Regional Housing Needs Assessment (RHNA) Allocation

The City's affordable housing needs are largely defined by the RHNA allocation determined by the San Diego County Association of Governments ("SANDAG"). RHNA determines the total number of new homes that would need to be built in a region to support housing demand by income category. The Housing Element identifies sites where new housing can be built to support the City's RHNA targets.

California's Department of Housing and Community Development ("HCD") defines household income levels for affordable housing as "Very Low-", "Low-", and "Moderate-income" for households that earn less than 50, 80, or 120% of the area median income ("AMI") for San Diego County ("County"), respectively. A corresponding "affordable housing cost" limit is set based on these qualifying income limits, and generally may not exceed 30% of household income. For renters, housing cost includes rent plus utilities. For homeowners, housing cost includes mortgage principal and interest, plus taxes, insurance, and HOA fees, if applicable.

The City's RHNA for the 6th Housing Element Cycle period of 2021 through 2029 reflects a target of 11,105 new residential housing units, of which 25% are for Very Low-income households, 16% are for Low-Income households, 17% are for Moderate-Income households, and 42% are for Above Moderate-income households. Table 1 shows this breakdown both exclusive and inclusive of Above Moderate-income housing, which is not considered affordable housing. Note that the RHNA allocations below exclude a category for "Extremely Low-income" housing, which is for households that earn less than 30% of the AMI, since this income level is not differentiated by SANDAG but is grouped within the Very Low-income allocation in Table 1.

Table 1: City's RHNA Allocation and Unit Production

Affordability Level	RHNA Allocation	% of Total	% of Affordable	Actual Unit Production
Above Moderate-Income	4,667	42%		4,172
Moderate-Income	1,911	17%	30%	0
Low-Income	1,777	16%	28%	342
Very Low-Income	2,750	25%	43%	107
Total	11,105	100%		4,621

Source: City of Chula Vista, SANDAG
Note: Actual Unit Production as of 10/25/2023

As of October 25, 2023, the City's actual unit production for the 2021-2029 RHNA cycle amounted to 4,621 units, primarily attributed to the production of 4,172 units in the Above Moderate-income category. The City has produced about 89% of the Above Moderate-income RHNA requirement for the 2021-2029 Housing Element Cycle. The City has not produced any Moderate-income units, but has produced 342 and 107 units, respectively, in the Low- and Very Low-income categories during the current Housing Element Cycle. These represent about 19% of the Low- and 4% of the Very Low-income RHNA allocations.

Absent land use regulations, incentives, and subsidies, the real estate development market will seldom provide affordable housing on its own. Either market rate developers must be required to provide it, or affordable developers must be subsidized by local, regional, state, or federal programs or, more often, all of the above. Because cities have limited means to incentivize or subsidize production of affordable housing, they are increasingly looking to multi-pronged and integrated strategies to encourage the production of housing at all income levels. The City's Policy causes the production of affordable units within a project or generates funding with an in-lieu fee option to support a wider range of housing opportunities in the City.

Inclusionary Housing Programs in California

Inclusionary housing programs are enacted by cities and counties typically by an ordinance that requires residential development applications, as a condition of approval, to include a portion of the units constructed in a project to be set aside for purchase or rent by lower income households. Inclusionary policies attempt to capture some of the value generated by new residential development to provide a community benefit, using local land use controls to ensure that much-needed affordable housing is produced along with market rate units. It is a flexible tool that can be tailored to local circumstances. There is no one model policy, but rather several best practices to consider when designing or updating an inclusionary program. An inclusionary housing ordinance is only one part of an affordable housing strategy and should not be viewed as the sole means to address the need for affordable housing, which may still require public subsidies and other policies, programs, and tools.

Affordable housing units are typically restricted by covenants recorded on the property to ensure that the units remain affordable for a long duration, usually 55 years for rentals and 45 years for ownership housing. During the covenant term, it is not uncommon for units to be rehabilitated or

refinanced and the covenants to be extended, often requiring additional public subsidies. In some cases, such as when a land trust or other public entity retains ownership of the land or units, the units can remain affordable in perpetuity.

Over 170 communities in California have enacted inclusionary housing ordinances or policies. The City is one of ten inclusionary housing policies adopted by cities in the County. The County of San Diego also has its own inclusionary housing policy for unincorporated areas of the County.

Legal Authority for Establishing Inclusionary Requirements and Affordable Housing Fees

In California, cities can regulate the use of buildings, structures, and land pursuant to Government Code Section 65850. This includes the type of land uses, building heights, parking requirements, and other improvements to property. In some cases, this can also include inclusionary housing requirements on residential and mixed-use projects.

Inclusionary housing policies have been in place throughout California since the 1970s. However, cities temporarily lost their ability to apply inclusionary policies to rental housing in 2009, when an appellate court determined that inclusionary housing requirements on new rental housing were in violation of the Costa Hawkins Act, a state law that limits local rent control implementation. In 2017, Assembly Bill ("AB") 1505 (Bloom) reinstated cities' ability to adopt and enforce inclusionary housing ordinances that apply to both for-rent and for-sale housing projects, thereby restoring a tool for cities to facilitate affordable housing development in their communities. Under Government Code Section 65850.01(a), HCD has the authority to review inclusionary housing ordinances adopted after September 2017 that require more than 15% of the units to be affordable. The purpose of this review is to ascertain whether a jurisdiction is impairing the production of market rate housing by requiring an excessive number of inclusionary units.

In 2015, the California Supreme Court ruled that inclusionary housing requirements are not an "exaction" that needs to be justified by the impact of a project, like traffic and other development impact fees. Inclusionary policies may be based on the existing and projected housing needs of the region and other factors related to the regional welfare, and not based on a demonstrated additional need for affordable housing generated by new residential development. This means that a "nexus study" is not required under Government Code Section 66000, commonly known as the Mitigation Fee Act.

Regardless of the threshold of inclusionary housing required, Government Code Section 65850(g) requires that inclusionary housing ordinances contain alternative means for compliance, including, but not limited to, the payment of in-lieu fees, land dedication, off-site construction, and preservation of existing units. Most ordinances provide several such alternatives.

Although the City's existing Policy is not an inclusionary housing ordinance subject to Government Code Section 65850(g), it does offer alternative means for compliance.

SECTION 2: CHULA VISTA HOUSING MARKET AND PRODUCT TYPES

RSG reviewed historical developments, the City's existing zoning code and Sectional Planning Area plans, and the residential development pipeline for the City and determined that the most common development patterns in the City and surrounding market area include single-family residences, condo or townhomes, and multi-family rental apartments at several different densities. Accordingly, the product types used in this analysis include single-family residential development, condo or townhome development, and multi-family rental apartment developments of varying sizes and densities. Based on the data reviewed, discussions with City staff and some active local developers, as well as RSG's knowledge of the residential market, RSG believes that these product types provide an accurate cross section of the potential residential developments affected by the Policy.

RSG analyzed sales data for the 12 months beginning in July 2022 and ending in June 2023 to develop assumptions about for-sale residential product types within the City. RSG utilized ParcelQuest to obtain a database of all residential properties sold in the City during this time. ParcelQuest utilizes County Assessor data to provide property information, including sales information and property characteristics. For multi-family rental residential properties, RSG used market analytics to develop assumptions. RSG relied on Costar market and submarket analytics reports, which summarize market rental rates by number of bedrooms.

The five general market rate residential product types are summarized in Table 2 below, including the typical development density, unit size, and development costs. The estimated development costs were based on independent construction cost data obtained from CoreLogic Marshall and Swift Valuation Services, which is a national comprehensive cost-estimating tool and methodology that is updated monthly and serves the appraisal, development, and insurance industries. The resulting assumptions represent averages for prototypical development types seen in the Chula Vista market as shown in Table 2.

Table 2: Summary of Development Prototypes

Development Prototypes	Single Family Residential	Condo/ Townhome	Low Density Multifamily	Med Density Multifamily	High Density Multifamily
Dwelling Units per Acre	8.7	25.0	25.0	30.0	65.0
Lot Square Feet per Unit	5,000	1,742	1,742	1,452	670
Average Unit Square Footage	2,250	1,675	1,110	945	910
Development Cost per Square Foot	$345	$322	$437	$433	$561
Development Cost per Unit	$709,927	$512,614	$462,704	$411,557	$527,221

Sources: City of Chula Vista, Costar, ParcelQuest, CoreLogic, RSG

SECTION 3: AFFORDABLE HOUSING COSTS

Monthly rents and sale prices for affordable housing units in California are usually established in accordance with the California Health & Safety Code ("HSC"). Calculations for rental housing are made pursuant to HSC Section 50053(b); calculations for owner-occupied housing are made pursuant to HSC Section 50052.5(b). Affordable housing costs are a function of the AMI, adjusted for family size appropriate to the unit, which is assumed to be one person in a studio unit, two persons in a one-bedroom unit, three persons in a two-bedroom unit, four persons in a three-bedroom unit, five persons in a four-bedroom unit, and so on.

The qualifying income limits for Extremely Low-, Very Low-, Low-, and Moderate-income households adjusted for household size are established annually by HCD for each California county in accordance with data provided by the United States Department of Housing and Urban Development ("HUD"). For the County, the 2023 median income for a household of four is established at $116,800. Table 3 below shows the range of the 2023 County AMIs by household size and the qualifying income limits by category.

Table 3: San Diego County Income Limits

		Income Limit by Household Size (Persons)				
Income Category	**AMI**	**1**	**2**	**3**	**4**	**5**
Extremely Low	30%	$24,525	$28,035	$31,530	$35,040	$37,845
Very Low	50%	40,875	46,725	52,550	58,400	63,075
Low	60%	49,050	56,070	63,060	70,080	75,690
Median	100%	81,750	93,450	105,100	116,800	126,150
Moderate	110%	89,925	102,795	115,610	128,480	138,765

Sources: California Department of Housing and Community Development, RSG

This Analysis incorporates the data in Table 3 to calculate affordable housing cost, rents, and prices based on the income category of the household, adjusted for family size.

Affordable Rents and Rental Unit Values

The maximum affordable rental costs are calculated per HSC Section 50053(b) to reflect the affordable housing cost by income category, adjusted for household size, net of a deduction for utility allowance. The calculation of annual affordable rental housing cost may not exceed the following:

- For Very Low-income households, the product of 30% times 50% of the AMI adjusted for family size appropriate for the unit.
- For Low-income households, the product of 30% times 60% of the AMI adjusted for family size appropriate for the unit.
- For Moderate-income households, the product of 30% times 110% of the AMI, adjusted for family size appropriate for the unit.

The County 2023 maximum affordable monthly rents for each income category by unit size is summarized in Table 4 below. Note that the amounts shown in Table 4 are prior to deducting a utility allowance, vacancy, operating expenses, reserves, and real estate taxes.

Table 4: San Diego County Affordable Rent Limits

	Rent Limit by Number of Bedrooms				
Income Category	**0**	**1**	**2**	**3**	**4**
Very Low	$1,022	$1,168	$1,314	$1,460	$1,577
Low	1,226	1,402	1,577	1,752	1,892
Moderate	2,248	2,570	2,890	3,212	3,469

Sources: California Department of Housing and Community Development, RSG

The value of an affordable rental unit is a function of the net income it provides the property owner. This is determined by calculating the annual gross income generated by the unit reduced by vacancies and operating expenses to determine the net operating income ("NOI"). Lenders' underwriting standards generally incorporate a 5% vacancy factor. Comparable annual operating expenses (excluding real estate taxes) for affordable rental units are about $6,000 per unit per year plus $250 per unit for annual reserve fund deposits. Real estate taxes are assumed at a rate of 1.25% of unit value. Although most affordable apartments are constructed by non-profit housing developers and are exempt from property taxes, for the purpose of this Analysis we have included real estate taxes because the inclusionary units would be within a market rate development subject to real estate taxes. The NOI for the affordable unit represents the affordable rent by income category less vacancy, operating expenses, reserves, and real estate taxes.

To establish the value of affordable rental units, RSG followed industry practice of applying a market capitalization rate, or "cap rate" to the projected NOI per unit. Market cap rates are derived by real estate industry research firms which track sale prices and NOI for apartment projects. The cap rate represents the relationship between NOI and sale value, and indicates a rate of return an investor may expect to achieve from ownership of the property.

RSG assumed a 4.5% cap rate based on current market data. Table 5 below shows the resulting capitalized value per rental unit for varying unit sizes and income levels based on affordable cost, NOI, and market cap rates.

Table 5: Capitalized Value of Prototype Affordable Rental Units

	NOI and Capitalized Value by Number of Bedrooms				
Income Category	**0**	**1**	**2**	**3**	**4**
Very Low Annual NOI	$3,467	$4,437	$5,340	$6,274	$6,648
Very Low Capitalized Value	$77,039	$98,602	$118,656	$139,426	$147,735
Low Annual NOI	$5,500	$6,767	$7,954	$9,179	$9,786
Low Capitalized Value	122,223	150,368	176,745	203,981	217,462
Moderate Annual NOI	$15,666	$18,414	$21,024	$23,704	$25,474
Moderate Capitalized Value	348,141	409,202	467,193	526,758	566,094

Sources: California Department of Housing and Community Development, Costar, Real Estate Research Corporation, CBRE, RSG

Affordable Sale Prices

Maximum affordable sale prices are calculated per HSC Section 50052.5(b) to reflect the affordable housing cost per income category, adjusted for household size, as a percentage of the gross AMI, allowing for the deduction of related housing expenses.

The calculation of annual affordable for-sale housing cost may not exceed the following:

- For Very Low-income households, the product of 30% times 50% of the AMI, adjusted for family size appropriate for the unit.
- For Low-income households, the product of 30% times 70% of the AMI, adjusted for family size appropriate for the unit.
- For Moderate-income households, not less than 28% of the household's gross income, or more than the product of 35% times 110% of the AMI, adjusted for family size appropriate for the unit.

Table 6 below identifies the County 2023 monthly affordable for-sale housing cost limits by income category and unit size, as calculated in accordance with the above formulas.

Table 6: Monthly Affordable For-Sale Cost Limits

	Cost Limit by Number of Bedrooms				
Income Category	**0**	**1**	**2**	**3**	**4**
Very Low	$1,022	$1,168	$1,314	$1,460	$1,577
Low	1,431	1,635	1,839	2,044	2,208
Moderate	2,623	2,998	3,372	3,747	4,047

Sources: California Department of Housing and Community Development, RSG

For this Analysis, affordable sale prices were calculated for single-family residences by determining what mortgage payment a qualifying household could afford, after deducting from affordable cost for estimated homeowner expense categories (i.e., taxes, insurance, maintenance costs, and utilities). The Analysis assumes a 5% down payment and a 30-year amortized loan at a 6.0% interest rate. The estimated affordable sale prices by income category and unit size are summarized in Table 7 below.

Table 7: Affordable Sales Prices

	Affordable Price by Number of Bedrooms				
Income Category	**0**	**1**	**2**	**3**	**4**
Very Low	$98,336	$108,276	$117,126	$126,495	$127,324
Low	160,418	179,414	196,941	215,193	223,128
Moderate	341,490	386,900	429,732	473,897	502,555

Sources: California Department of Housing and Community Development, RSG

Affordable Housing Development Funding Gap

The affordable housing development funding gap reflects the difference between the estimated cost to develop the unit, which is based on construction costs in the market area, and the value that a developer can expect to receive from the affordable unit, which is determined by the affordable rent or sales price as shown above. Therefore, the development funding gap is an indication of the net cost to create an affordable housing unit, which is funded either by a developer under an inclusionary program or through a subsidy program or other source.

The cost per unit for affordable housing units is similar to those for market rate units, with an exception perhaps for somewhat smaller unit sizes, and slightly lower quality materials and finishes. The methodology herein reflects the assumption of all things being equal for each prototype, such as unit size, construction costs, and land costs. RSG calculated a weighted average affordable development funding gap for each of the prototypes by blending the affordable values of the different bedroom unit sizes within each prototype project. Table 8 below shows the development funding gaps for affordable units by product type and income level.

Table 8: Affordable Development Funding Gap

	Single Family Residential	Condo/ Townhome	Low Density Multifamily	Med Density Multifamily	High Density Multifamily
Development Cost per Unit	$709,927	$512,614	$462,704	$411,557	$527,221
Very Low Affordable Housing Value	127,324	126,495	116,865	110,706	110,634
Very Low Affordable Housing Gap	(648,893)	(439,270)	(393,000)	(343,268)	(476,636)
Low Affordable Housing Value	223,128	215,193	174,365	166,280	166,195
Low Affordable Housing Gap	(553,089)	(350,572)	(335,500)	(287,694)	(421,076)
Moderate Affordable Housing Value	502,555	473,897	461,866	444,154	443,997
Moderate Affordable Housing Gap	(273,662)	(91,868)	(47,999)	(9,820)	(143,274)

Sources: California Department of Housing and Community Development, City of Chula Vista, Costar, ParcelQuest, CoreLogic, Real Estate Research Corporation, CBRE, RSG

The development funding gaps shown in Table 8 reflect the financial impacts associated with producing these affordable units without the benefit of tax credits or other funding sources often used by affordable housing developers, thus reflecting the full amount to produce an affordable unit for each income category. Developers of affordable housing projects are often awarded financial assistance from local, state, and federal funding sources, such as 4% or 9% Low-Income Housing Tax Credits (“LIHTC”), which reduce the funding deficits and make the development more financially feasible. However, these subsidies are not available to market rate developers complying with inclusionary programs. Accordingly, this analysis uses the full funding gap amounts as the initial basis for determining the cost of compliance with the Policy.

SECTION 4: POLICY DESIGN OPTIONS AND BEST PRACTICES

As the City considers amending its Policy, RSG has provided the following design element questions and a brief discussion of options and best practices based on the experience of other communities with inclusionary requirements. The goal of the Policy should be to increase the diversity of housing prices/rents throughout the community and ensure that a range of available and affordable prices/rents continues over time. The Policy should be backed by data and research that establishes both the need and feasibility of producing affordable housing in the regional housing market.

- What percentage of affordable units should be included in a project?

Most inclusionary policies in California are in the range of 5 to 20%, with 15% the most common requirement. Four cities in San Diego County have 15% inclusionary requirements, another four cities in San Diego County and the County (applicable to unincorporated developments) have 10% inclusionary requirements, while two cities in San Diego County have 20% inclusionary requirements. The inclusionary percentage a community establishes is dependent on its affordable housing needs, local market conditions, financial incentives available, and the mix of affordability required. Ultimately, the percentage should not be so high that the cost of providing the affordable units making the entire project infeasible and thus discourages most housing development.

- At what income levels should affordable units produced under the Policy be sold or rented?

There is wide variability among communities for the required target distribution of units by income level within the overall inclusionary percentage. For some jurisdictions, the distribution among income levels may be set to approximate their RHNA allocation. For many others, the inclusionary requirement is split only between Low- and Very Low-Income levels (for example, if 15% of the total units are to be affordable, 10% may be for Low-income and 5% for Very Low-income households). Moderate-income units may be included in requirements for some communities, especially those with very high cost and relatively higher incomes; in many other markets, unrestricted market rate housing is being produced that is already naturally affordable to Moderate-income households. In Chula Vista, for example, the value of a condo or townhome affordable to Moderate-income households exceeds the cost to build the condo or townhome, resulting in a feasibility surplus. Some communities include a target for Extremely Low-income households but, given the high level of subsidy required, housing at this income level is generally better served by other programs and targeted funding sources. Lastly, many inclusionary programs have different income level targeting for ownership and rental housing, reflecting the differences in development economics for each product type.

- Should the Policy's affordable unit production requirement change over time?

Housing markets are constantly changing, including rents, sale prices, and construction and financing costs. Developer profitability rises and falls over time based on a variety of market factors, and required returns can vary from one developer to the next. The cost of compliance with an inclusionary policy may be only a relatively minor consideration among many factors for

development feasibility. A modest inclusionary requirement that is evaluated to be feasible when adopted should likely remain feasible over time. It is also possible that, when profitability increases, a higher inclusionary requirement could be feasibly absorbed by the development community. Periodic review can determine how feasibility is impacted by market changes. It can also allow the community to assess whether changes in the target income levels may be necessary to better meet housing targets. Every three to five years is a reasonable review period. Coupling the review with the update to the City's Housing Element is another good option.

- What alternative methods of compliance should be provided?

In California, state law requires that alternative methods of compliance with inclusionary housing requirements be provided to developers. Common alternatives include in-lieu fees, off-site construction, land donation, and the acquisition and rehabilitation of existing units.

In-lieu fees are generally paid into a local affordable housing trust fund to finance future construction of affordable housing at other locations in the community. The greatest advantage of in-lieu fees is that they provide a local funding source that can be leveraged with state and federal funds that otherwise would not be available to a developer, allowing an even greater number of affordable units to be built, often at much deeper affordability levels. By leveraging local affordable housing trust funds, developers may be able to produce four to six times more units than would otherwise be developed as inclusionary housing units.

- How should the amount of an in-lieu fee be determined? Should it be set as a per unit fee or a per square foot fee?

As a starting point, the in-lieu fee should reflect the true cost of producing on-site units. If the fee is lower than the actual cost of production, developers are very likely to pay it rather than designate any units in the project as affordable. Even at an equivalent or comparable cost, developers are still more likely to pay the fee rather than assume long-term management of affordability covenants associated with a small fraction of units.

The cost of providing an inclusionary unit will vary by which income levels are required and the size and type of unit. A range of such costs can be projected using current market economics and prototypical development. A standardized in-lieu fee can only approximate these costs based on the range of policy options being included.

The in-lieu fee should be reviewed and revised over time to reflect changes in construction costs, inflation, and other market factors. While an inclusionary policy is usually adopted by an ordinance, the in-lieu fee is best adopted by resolution since amending the ordinance on a regular basis can be more costly and time-consuming.

In-lieu fees are often denoted as the amount a developer would need to pay *per market rate unit* in a project to meet its obligation, rather than the net cost of each inclusionary unit that otherwise would be required to be built on-site. In other words, if there was an inclusionary requirement of 10%, the in-lieu fee per market rate unit multiplied by ten should approximate the average net cost of providing one inclusionary unit. Establishing the in-lieu fee on a per-market-rate-unit basis is quite common because developers typically evaluate development projects in terms of cost per

unit. However, the drawback with establishing a fee on a per-market-rate-unit basis is that it does not adjust for the size of units in a project and can lead to inequities in implementation. For example, a developer creating large multi-bedroom homes would pay the same in-lieu fee per unit as a developer of small one-bedroom or studio units, even though the construction costs and affordable funding gaps are widely different. RSG typically recommends establishing the in-lieu fee on a *per square foot* basis that can then be multiplied by the total residential square footage in a project to calculate the inclusionary obligation. Conversely, establishing the in-lieu fee on a *per unit* basis can simplify program administration.

- What is the process or standard for requesting a waiver or reduction of the requirement?

The Policy should provide a clear and specific process for a developer to request a waiver or reduction, and the standards by which the request will be evaluated. The process should only be used in rare cases, and the developer should be required to demonstrate economic hardship (the inability to achieve a profit), which can be verified by an independent third-party review.

- What other communities in the region have inclusionary housing requirements?

When setting an affordable unit production requirement, it can be helpful to look at surrounding communities with similar policies so the City does not price itself out of new development. RSG researched communities in the County and determined that Chula Vista is one of ten cities in the County that has inclusionary housing requirements. The County of San Diego also has inclusionary housing requirements for unincorporated areas within the County.

Table 9 provides examples of inclusionary housing policies in ten San Diego County cities and the County for reference purposes. Several of these communities are in different housing markets, and thus the comparability of cities in closer proximity to Chula Vista should be weighted accordingly. The jurisdictions are listed in order of in-lieu fee per rental unit, which may or may not approximate the true cost of on-site compliance. For jurisdictions that have set a per market rate unit fee, RSG has estimated that same fee on a per square foot basis for comparison purposes using Chula Vista prototypes. Similarly, for jurisdictions with a per square foot fee, RSG estimated that fee on a per market rate unit basis.

Table 9: Inclusionary Requirements in Other Jurisdictions

City	Last Update	Inclusionary Req Rent	Inclusionary Req Sale	Minimum Units Rent	Minimum Units Sale	AMI Requirements Rent	AMI Requirements Sale	Fee Type	In-Lieu Fee per Unit Rent	In-Lieu Fee per Unit Sale	In-Lieu Fee per SF Rent	In-Lieu Fee per SF Sale
Poway	2018	15%	15% or 20%	1 unit	1 unit	VL	Low, Mod	Per Unit	$500		$0.53*	$0.22*
Coronado	1993	20%		2 units	2 units	Low, VL	Moderate	Per Unit	$7,000		$7*	$3*
San Marcos	In Progress	15%		1 unit	1 unit	Determined by City		Per Unit	$9,300 (1)		$10*	$4*
Chula Vista (Existing)	**1983**	**10%**		**50 units**	**50 units**	**Low (5%), Mod (5%)**		**Per Unit**	**$12,422**		**$13***	**$6***
Carlsbad	2022	15%		7 units	7 units	Low		Varies	$14,175*	$8,515	$15	$4*
Chula Vista (Recommended)	**In Progress**	**10%**		**1 unit**	**1 unit**	**Low (5%), Mod (5%)**		**Per SF**	**$15,120***	**$18,000***	**$16**	**$8**
Encinitas	2021	15% or 20%		7+ units	7+ units	Low or VL		Per SF	$18,900*	$45,000*	$20	
Oceanside	2022	10%		3+ units	3+ units	Low	Low, Mod	Per SF	$18,900*	$45,000*	$20	
San Diego	2023	10%	10% or 15%	5 to 10 units (2)	2+ units	Low, VL	Med, Mod	Per SF	$23,625*	$56,250*	$25	
San Diego County	2023	10%		10 units	10 units	Low, VL	Med, Mod	Per SF	$23,625*	$56,250*	$25	
Solana Beach	2023	10%		4+ units	4+ units	Low or VL		Per SF	$25,099*	$59,760*	$27	
Del Mar	2018	20%		2 units	2 units	Low, VL, EL (3)		Varies	$33,075*	$26,250 (4)	$35	$12*

(*) Asterisk indicates a calculated value using medium density multifamily prototype square footage (945 sf) and single family residential prototype square footage (2,250 sf)
(1) Figure shows most common in-lieu fee after negotiations
(2) Minimum units varies by Zoning designation
(3) Required number of units for each AMI category varies by project size
(4) Figure shows in-lieu fee per lot created
Note: List is sorted by in-lieu fee per unit for rental products.

SECTION 5: ANALYSIS OF BALANCED COMMUNITIES POLICY AFFORDABLE UNIT PRODUCTION OPTIONS AND IN-LIEU FEE LEVELS FOR THE CITY OF CHULA VISTA

This section discusses the potential cost of compliance under a range of program design options and concludes with RSG's recommendations for an amended City Policy, ordinance, and in-lieu fee amounts.

RSG evaluated both the existing Policy and several permutations of program design options that the City might consider, as summarized in Table 10 below.

Table 10: Range of Program Policy Options Evaluated

On-Site Affordable Unit Production Percentage	10% (Existing Policy)	15%
Income Level Targeting	50% Low and 50% Moderate (Existing Policy)	RHNA allocation based
Fee Basis	Per market rate unit (Existing Policy)	Per square foot
Variable or Fixed Fee	Fixed fee for all types and tenure (Existing Policy)	Variable by tenure (for-sale vs. for-rent)

Using the program policy options listed in Table 10, RSG evaluated the feasibility of 4 different alternative design combinations in this Report, as outlined in Table 11.

Table 11: Program Design Options

Design Option	On-Site Affordable Unit Production Percentage	Income Level Targeting	Fee Basis	Variable or Fixed Fee
Existing Balanced Communities Policy	10%	50% Low and 50% Moderate	Per unit	Fixed fee for all types and tenure
Design Option 1	10%	50% Low and 50% Moderate	Per square foot	Variable by tenure (for-sale vs. for-rent)
Design Option 2	15%	50% Low and 50% Moderate	Per square foot	Variable by tenure (for-sale vs. for-rent)
Design Option 3	10%	RHNA allocation based	Per square foot	Variable by tenure (for-sale vs. for-rent)
Design Option 4	15%	RHNA allocation based	Per square foot	Variable by tenure (for-sale vs. for-rent)

RSG used the affordable development funding gap amounts by prototype from Table 8 to calculate equivalent in-lieu fees for the different program design options noted in Table 10 and 11. First, RSG applied the income level targeting design options (RHNA, or 50% Low and 50% Moderate) across the affordable housing gaps calculated in Table 8, resulting in a weighted affordable housing gap for the different options. The calculation of weighted affordable housing gap for different income targeting and prototype combinations is presented in Table 12.

Table 12: Income Level Targeting Weighted Affordable Housing Gap

	Single Family Residential	Condo/ Townhome	Low Density Multifamily	Med Density Multifamily	High Density Multifamily
Very Low Affordable Housing Gap	($648,893)	($439,270)	($393,000)	($343,268)	($476,636)
Low Affordable Housing Gap	(553,089)	(350,572)	(335,500)	(287,694)	(421,076)
Moderate Affordable Housing Gap	(273,662)	(91,868)	(47,999)	(9,820)	(143,274)
Policy Income Level Targeting					
Design Options 1 and 2: 50% low/50% mod					
Very Low Income	0%	0%	0%	0%	0%
Low Income	50%	50%	50%	50%	50%
Moderate Income	50%	50%	50%	50%	50%
Weighted Affordable Housing Gap	($413,376)	($221,220)	($191,749)	($148,757)	($282,175)
Design Options 3 and 4: RHNA					
Very Low Income	43%	43%	43%	43%	43%
Low Income	28%	28%	28%	28%	28%
Moderate Income	30%	30%	30%	30%	30%
Weighted Affordable Housing Gap	($511,069)	($311,668)	($274,722)	($228,951)	($362,348)

Sources: RSG

The weighted affordable housing gaps presented in Table 12 are further adjusted for the varying design option levels of on-site affordable unit production percentage (10% or 15%). The product resulting from multiplying the weighted affordable housing gaps by the affordable unit production percentage represents the weighted average per-market-rate-unit in-lieu fee that a project might be charged, as presented in Table 13.

Table 13: Calculated In-Lieu Fee per Unit

	Single Family Residential	Condo/ Townhome	Low Density Multifamily	Med Density Multifamily	High Density Multifamily
Weighted Affordable Housing Gap					
Design Options 1 and 2: 50% low/50% mod	($413,376)	($221,220)	($191,749)	($148,757)	($282,175)
Design Options 3 and 4: RHNA	($511,069)	($311,668)	($274,722)	($228,951)	($362,348)
Calculated In-Lieu Fee per Unit					
Affordable Unit Production Percentage: 10%	X 10%	X 10%	X 10%	X 10%	X 10%
Design Option 1: 10%, 50% low/50% mod	($41,338)	($22,122)	($19,175)	($14,876)	($28,217)
Design Option 3: 10%, RHNA target	($51,107)	($31,167)	($27,472)	($22,895)	($36,235)
Affordable Unit Production Percentage: 15%	X 15%	X 15%	X 15%	X 15%	X 15%
Design Option 2: 15%, 50% low/50% mod	($62,006)	($33,183)	($28,762)	($22,314)	($42,326)
Design Option 4: 15%, RHNA target	($76,660)	($46,750)	($41,208)	($34,343)	($54,352)

Sources: RSG

RSG then translated these per unit in-lieu fees to a per-square-foot basis for each of the prototypical housing development types. The in-lieu fee per unit is divided by the prototype unit square footage, taken from Table 2. The quotient represents the in-lieu fee per square foot, as illustrated in Table 14.

Table 14: Calculated In-Lieu Fee per Unit and per Square Foot

	Single Family Residential	**Condo/ Townhome**	**Low Density Multifamily**	**Med Density Multifamily**	**High Density Multifamily**
Prototype Unit Square Feet	2,250	1,675	1,110	945	910
Design Option 1: 10%, 50% low/50% mod					
Calculated In-Lieu Fee per Unit	($41,338)	($22,122)	($19,175)	($14,876)	($28,217)
Calculated In-Lieu Fee per Square Foot	($18)	($13)	($17)	($16)	($31)
Design Option 2: 15%, 50% low/50% mod					
Calculated In-Lieu Fee per Unit	($62,006)	($33,183)	($28,762)	($22,314)	($42,326)
Calculated In-Lieu Fee per Square Foot	($28)	($20)	($26)	($24)	($47)
Design Option 3: 10%, RHNA target					
Calculated In-Lieu Fee per Unit	($51,107)	($31,167)	($27,472)	($22,895)	($36,235)
Calculated In-Lieu Fee per Square Foot	($23)	($19)	($25)	($24)	($40)
Design Option 4: 15%, RHNA target					
Calculated In-Lieu Fee per Unit	($76,660)	($46,750)	($41,208)	($34,343)	($54,352)
Calculated In-Lieu Fee per Square Foot	($34)	($28)	($37)	($36)	($60)

Sources: RSG

RSG calculated prospective in-lieu fees that are roughly equivalent to the cost of on-site compliance based on the on-site affordable unit production percentage of units, the income level targeting mix, and the projected funding gap. These costs will be different for each prototype due to their differing development economics. This approach to calculating potential in-lieu fees is an important departure from the existing Balanced Communities Policy which had a set a per unit in-lieu fee that had not been adjusted for many years and was not calibrated to the actual cost of compliance for different development types or with regard to changing market conditions. In fact, our analysis indicates that the existing Policy in-lieu fee is well below the actual projected cost of on-site compliance with the inclusionary requirement. RSG recommends setting the in-lieu fee to be more closely aligned with the actual projected cost of on-site compliance so that it is truly an equivalent alternative.

Developers are typically motivated to seek the least costly path of compliance. When the adopted in-lieu fee is less than the actual projected cost to include affordable units on-site, developers are more likely to pay the in-lieu fee than provide units on site. Conversely, when the adopted in-lieu fee is greater than the actual projected cost to include units on-site, developers are more likely to include affordable units in their projects. With an in-lieu fee that is more closely aligned with the actual projected cost of including units on-site, developers will consider project-specific economics and other factors (such as community support and goodwill) to determine how they

choose to comply. Some cities may intentionally set an in-lieu fee amount that is lower than the actual projected cost of on-site compliance with the expectation that most developers will pay the fees rather than include affordable units on-site. Those cities will aggregate and contribute those funds towards projects that leverage regional, state, and federal funding sources to produce a greater number of affordable units at deeper affordability levels.

Feasibility of Prototypes, Existing Policy, and Alternative Policy Design Options

In the next phase of this Analysis, RSG evaluated the impact of the range of design options on the feasibility of development. This is an essential step before setting an inclusionary percentage requirement and associated in-lieu fee because setting them too high may deter residential development altogether, thereby increasing housing costs and negating the purpose of the Policy. To avoid this unintended consequence, the City can modulate program requirements or reduce the in-lieu fee to mitigate the cost impacts on development.

As a measure of feasibility, RSG evaluated two common benchmarks used in real estate development investment decisions: projected "profit margin" and "yield on cost". For evaluating ownership housing product type feasibility, "profit margin" is defined as development project value divided by development costs. As a rule of thumb, projected profit margin should exceed market cap rates by 1.5 to 2.5%. For multifamily rental product types, "yield on cost" is defined as stabilized net operating income as a percent of development costs. As a rule of thumb, the projected yield on cost should exceed market cap rates by 1.0%.

For the purpose of this Analysis, RSG evaluated the feasibility of each for-sale housing prototype using a 7% minimum profit margin. With current cap rates for multifamily residential projects ranging from 4.25 to 5.5%, projected profit margins should range from 5.75 to 8% for ownership prototypes to be deemed feasible after applying the in-lieu fee.

For the purpose of this Analysis, RSG evaluated the feasibility of the rental housing prototypes using a 5.5% minimum yield on cost. Based on current cap rates for multi-family residential projects, projected yield on cost should range from 5.25 to 6.5%.

Using the metrics described above, RSG evaluated the feasibility of each of the residential prototypes (a) without any inclusionary requirement, (b) under the existing Policy, and (c) using the weighted costs of compliance under each of the potential design options illustrated in Tables 10-14. RSG's analysis resulted in the following findings, as further illustrated in Table 15 below:

- All residential prototypes are currently feasible without any inclusionary requirement.
- A 15% on-site affordable unit production percentage is infeasible for all prototypes.
- A 10% on-site affordable unit production percentage is feasible for multifamily prototypes, but infeasble for ownership prototypes. This also indicates that on-site compliance with the existing Balanced Communities Policy is currently infeasible for ownership residential types.

- The existing Policy in-lieu fee is feasible currently for all residential prototypes. However, as described earlier, the existing fee is outdated and does not match the actual projected cost of on-site compliance.

- The maximum in-lieu fee that is projected to allow for feasible development under current market conditions would be $8 per square foot and $16 per square foot, respectively, for ownership and rental prototypes. With the exception of the medium density multifamily prototype, all of the recommended in-lieu fee amounts would be less than the average cost of on-site compliance. The City may wish to consider phasing in increases to these fee levels after the real estate development market improves so that they more closely approximate the projected cost of compliance with the on-site 10% inclusionary requirement.

Table 15: Feasibility of Protypes, Existing Policy, and Recommended Policy

	Single Family Residential	Condo/ Townhome	Low Density Multifamily	Med Density Multifamily	High Density Multifamily
Prototype Feasibility					
Prototype Unit Square Feet	2,250	1,675	1,110	945	910
Unit Market Value	$786,683	$564,094	$654,000	$580,000	$765,333
Developer Cost per Unit	$709,927	$512,614	$462,704	$411,557	$527,221
Developer Return per Unit	$76,756	$51,479	$191,296	$168,443	$238,113
Profit Margin (For-Sale)	10.81%	10.04%			
Yield on Cost (For-Rent)			6.36%	6.34%	6.53%
Minimum Profit Margin/Yield on Cost	*7.00%*	*7.00%*	*5.50%*	*5.50%*	*5.50%*
Feasibility Test	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**
Existing Balanced Communities Policy					
On-Site Compliance Cost per Market Rate Unit*	$41,300	$22,100	$19,200	$14,900	$28,200
On-Site Compliance Cost per Square Foot*	$18	$13	$17	$16	$31
Profit Margin with On-Site Compliance	4.7%	5.5%			
Yield on Cost with On-Site Compliance			5.8%	5.8%	5.8%
Feasibility Test	**No**	**No**	**Yes**	**Yes**	**Yes**
Existing In-Lieu Fee per Market Rate Unit	$12,440	$12,440	$12,440	$12,440	$12,440
Existing In-Lieu Fee per Square Foot*	$6.00	$7.00	$11.00	$13.00	$14.00
Profit Margin with Existing Fee (For-Sale)	8.90%	7.44%			
Yield on Cost with Existing Fee (For-Rent)			6.19%	6.16%	6.38%
Minimum Feasibility Threshold	*7.00%*	*7.00%*	*5.50%*	*5.50%*	*5.50%*
Feasibility Test	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**
Recommended Balanced Communities Policy					
10% of all units, 50% low/50% mod					
Recommended In-Lieu Fee Per Square Foot	$8.00	$8.00	$16.00	$16.00	$16.00
Recommended In-Lieu Fee per Market Rate Unit*	$18,000	$13,400	$17,760	$15,120	$14,560
Total Average Unit Cost with Recommended Fee	$727,927	$526,014	$480,464	$426,677	$541,781
Developer Return per Unit with Recommended Fee	$58,756	$38,079			
Profit Margin (For-Sale)	8.07%	7.24%			
Yield on Cost (For-Rent)			5.77%	5.81%	5.83%
Minimum Feasibility Threshold	*7.00%*	*7.00%*	*5.50%*	*5.50%*	*5.50%*
Feasibility Test	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**

Sources: City of Chula Vista, California Department of Housing and Community Development, Costar, ParcelQuest, CoreLogic, Real Estate Research Corporation, CBRE, RSG

* These are estimates calculated based on prototypes and averages.

Based on the foregoing Analysis, RSG recommends an inclusionary housing policy with:

- **A 10% on-site production requirement;**
- **Targeting 50% of affordable units for Low-income households and 50% for Moderate-income households;**
- **An in-lieu fee of $8 per square foot for ownership product types; and**
- **An in-lieu fee of $16 per square foot for rental product types.**

SECTION 6: CONCLUSION AND POLICY OPTIONS

The following presents a summary of RSG's policy recommendations:

Policy	Recommendations
On-site affordable unit production requirement	**RSG recommends maintaining the on-site affordable unit production requirement of 10% at this time for all residential types.** Although feasibility may be challenging under current market conditions for ownership prototypes to provide on-site units at this level, such conditions should improve over time. By setting an in-lieu fee that is relatively lower than the cost of on-site compliance, new development can remain feasible.
Income-Level Targeting	**RSG recommends an affordability mix of 50% moderate and 50% low for for-sale and rental product types.** The existing Policy also allows developers of all housing types, when opting for on-site affordable unit production, to provide 50% moderate and 50% low income units on site.
Project Threshold Size Subject to Policy	**RSG recommends that all housing development, or at least developments with 10 units or more, contribute to affordable housing production through either the inclusion of affordable units or payment of a proportionate in-lieu fee.** The existing Policy exempts residential developments with less than 50 residential units. Based on research of other inclusionary housing policies in the County, and RSG's experience with inclusionary housing throughout the State of California, it is uncommon to exempt developments of less than 50 residential units. Some cities exempt developments of 10 units or less from the on-site affordable unit production requirement, while still requiring the proportional payment of an in-lieu fee for partial units.
Exemptions	RSG recommends the following exemptions: • Non-residential development • Projects for which the City enters into a Development Agreement that includes inclusionary housing obligations and alternative community benefits

	• Affordable housing developments, and residential development undertaken by a public entity other than the City (ie Housing Authority) • Homeless shelters, community care facilities, health care facilities, and single room occupancy units • Replacement dwelling units for units that were demolished or destroyed within the five years prior to the construction of the new unit • Accessory dwelling units • Home remodels and additions • Density bonus units • Mobile homes • Any development project otherwise exempt under State law
Alternatives to On-Site Affordable Unit Production	The existing Policy outlines several alternatives to on-site affordable unit production, including payment of the in-lieu fee, off-site unit production (by construction of new units, acquisition and rehabilitation of existing units, transfer of credits from the City or another developer, or provision of housing projects or programs to meet the special needs of certain population groups within the community) and public benefits that provide a more effective and feasible means of satisfying the requirement. RSG recommends considering the following additional alternatives to on-site production: • Land dedication within the development project area to an affordable housing non-profit developer or the City • Other means subject to City Council approval
In-Lieu Fee	**Single Family/Condo $8 per square foot; and Multi-Family $16 per square foot.** Presently, the in-lieu fee is $124,000 per required affordable unit (or $12,400 per market rate unit). RSG recommends several changes to the in-lieu fee, as follows:

	• Set the fee per square foot of residential space. Per square foot in-lieu fees encourage smaller and more efficient units, while increasing density. • RSG recommends revisiting the in-lieu fee on a periodic basis, such as every 3 to 5 years or as market conditions change significantly. Alternatively, the fee may be reviewed and adjusted in accordance with Housing Element cycles. • The Policy should be adopted by the City Council as an Ordinance, while the in-lieu fee should be adopted as a Resolution. This helps to streamline and separate amendments to the fee alone without reconsidering the full program and policies.
Phased In Fee Increases	The recommended in-lieu fee of $8 for single family and condo prototypes is below the current projected cost of providing 10% of affordable units on-site. The fee is set to allow such projects with a feasible option in-lieu of on-site compliance. RSG recommends considering a phase-in of fee increase(s) over time, and as market conditions improve, so that the in-lieu fee for ownership residential products better approximates the actual projected cost of on-site compliance (currently estimated at $13-18 per square foot). Phase in of increases also allows the residential development market to adjust the changes over time.
On-Site Unit Production Development Standards	The City may consider the following requirements for on-site unit production: • Affordable units should be reasonably dispersed throughout the residential development. • Affordable units should be proportional, in number of bedrooms, square footage, and location, to the market rate units. • Affordable units should be comparable to the market rate units in size, design, materials, finish quality, and appearance. • Affordable units should be permitted the same access to project amenities and recreational facilities as the market rate units. • Affordable units should be constructed concurrent with, or before the construction of the market rate units.

	• For phased projects, a proportional share of the required inclusionary units shall be provided within each phase of the residential project.
Waivers or Reductions in Requirements	At the discretion of the City Council or City Administrator, when it is determined that it is infeasible for a residential development to meet the on-site production requirement due to costs, or other factors such as health and safety issues, the City should require the developer to show economic hardship, as verified by an independent third-party review, at the developer's cost.
Incentive Credit Amendment	**The Incentive Credit formula or unit credit under the existing Policy requires revision.** The incentive credit encourages developers to provide households with deeper affordability levels while reducing the overall required affordable housing obligation for the developer. Under the existing incentive credit option, the following unit credit is provided: • 2.0 unit credit for every Very Low-income unit in-lieu of a Moderate-income unit • 1.5 unit credit for every Low-income unit in-lieu of a Moderate-income unit • 0.5 unit credit for every Very Low-income unit in-lieu of a Low-income unit. As illustrated below, the 0.5 unit credit for Very Low-income units in-lieu of Low-income units results in a unit obligation that is double the original obligation. The developer's reduced obligation is reduced by dividing the unit obligation by the unit credit. For example, a developer with a 300-unit residential project has an inclusionary unit obligation of 30 units (10%), including 15 Moderate-income units and 15 Low-income units: • If the developer proposes to build all Low-income units, the unit obligation would be calculated as follows: 15 Moderate-income units divided by 1.5 unit credit equals 10 Low-income units. The total unit obligation after accounting for the Incentive Credit is 25 Low-income units

	• If the developer proposes to build all Very Low-income units, the unit obligation would be calculated as follows: 15 Moderate-income units divided by 2.0 unit credit equals 7.5 Very Low-income units, and 15 Low-income units divided by 0.5 unit credit equals 30 Very Low-income units. Because the unit credit for Very Low-income units in-lieu of Low-income units is less than 1.0, it results in an increase in Very Low-income units, which is not the intent of the Incentive Credit option. If the Incentive Credit were revised to align with affordability gaps, the Incentive Credit would provide the following unit credits to developers: • 6.0 unit credit unit credit for every Very Low-income for-sale unit in-lieu of a Moderate-income for-sale unit, and 3.5 unit credit unit credit for every Very Low-income for-rent unit in-lieu of a Moderate-income for-rent unit • 5.0 unit credit for every Low-income for-sale unit in-lieu of a Moderate-income for-sale unit, and 3.0 unit credit for every Low-income for-rent unit in-lieu of a Moderate-income for-rent unit • 1.5 unit credit for every Very Low-income for-sale or for-rent unit in-lieu of a Low-income for-sale or for-rent unit.