



Department: Community Development
Cost Center: 4003
For Agenda of: 3/1/2022
Placement: Study Session
Estimated Time: 120 minutes

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SUBJECT: INCLUSIONARY HOUSING ORDINANCE UPDATE AND BELOW
MARKET RATE HOUSING ADMINISTRATION STUDY SESSION

RECOMMENDATION

Receive a presentation and provide feedback on the City's current inclusionary housing requirements, a preliminary inclusionary housing update recommendation, and the progress to date on the onboarding of a Below Market Rate (BMR) Housing Administrator.

REPORT-IN-BRIEF

This Study Session provides background information and analysis of the City's current affordable housing requirements, a preliminary recommendation on updates to the City's Inclusionary Housing Ordinance, and an overview of progress of onboarding the City's Below Market Housing Administrator. Council is being asked to confirm that proposed policy changes align with Council policy preferences before it conducts further outreach and engagement in the community. Ultimately, staff plans to return to the City Council in Summer 2022 with a recommendation from the Planning Commission to update the City's Inclusionary Housing Ordinance. With this Study Session staff is requesting feedback from Council on four items: 1) fractional units, 2) the removal of Table 2A, 3) calculating the total number of inclusionary units based on land use rather than zoning, and 4) including provisions in the ordinance to codify the Below Market Rate (BMR) Housing Administrator's role. Additionally, staff is requesting feedback regarding the update of procedures and administrative documentation related to the BMR Housing Administration Program.

The City's first Inclusionary Housing Ordinance (IHO) was adopted in 1999. Since then, hundreds of affordable units have been constructed and financed to meet the requirements of the IHO. A lot has changed since 1999 and in 2020 the City hired consultant David Paul Rosen and Associates (DRA) to complete an Affordable Housing Nexus Study to evaluate the nexus between new commercial and market-rate residential development.

The Study confirmed that both market-rate residential and commercial development are inducing demand for affordable housing that is not being met by the current housing market.¹

The City Council has tasked the Community Development Department with updating the ordinance as part of the 2021-23 Major City Goal work program for Housing. The Housing Element (HE) Update adopted in 2020 also included a new program that says the City’s Inclusionary Housing Ordinance should be updated based on the information provided in the Nexus Study (HE Program 2.13). In addition to the Nexus Study, the City hired Economic & Planning Systems, Inc. (EPS) in April 2021 to conduct a feasibility analysis of the City’s proposed affordable housing in-lieu and commercial linkage fees based on the findings and recommendations included in the Nexus Study. EPS has developed a preliminary recommendation on changes to the City’s Inclusionary Housing Ordinance based on their feasibility analysis. Table 1 below provides an outline of the preliminary recommendation alongside the Nexus Study recommendations and the City’s current IHO. Council is being asked to confirm that proposed policy adjustments are aligned with the Council’s policy preferences before staff conducts further outreach and engagement in the community.

Table 1: Comparison of the City’s current IHO, the Nexus Study Recommendation, and EPS’ preliminary recommendation.

	Current IHO*	Nexus Study Recommendation	IHO Update Preliminary Recommendation
Where the IHO applies	Requirements differ within City Limits and Expansion Areas	Same requirements Citywide	Same requirements Citywide
Table 2A Adjustments	Applies to projects that qualify	Remove	Remove
Residential			
For Sale	<u>Within City Limits</u> : 3% low or 5% moderate income <u>Expansion Area</u> : 5% low and 10% moderate income	15% (5% at low and 10% at moderate)	10% (5% low-income units and 5% moderate income)
For Sale In-lieu Fee	<u>Within City Limits</u> : 5% of building valuation <u>Expansion Area</u> : 15% of building valuation	Apply on a square foot basis (no specific amount recommended)	\$25 per square foot

¹ According to the Nexus study, commercial development had a direct employment impact that generates demand for additional housing and the private for-profit housing market, with no public assistance, has not demonstrated the ability to meet the housing needs of low-earning employees.

	Current IHO*	Nexus Study Recommendation	IHO Update Preliminary Recommendation
For Rent	<u>Within City Limits</u> : 3% low or 5% moderate income <u>Expansion Area</u> : 5% low and 10% moderate income	15% very low- and low-income units (5% very low and 10% at low)	6% (3% very low-income and 3% low-income)
For Rent In-lieu Fee	<u>Within City Limits</u> : 5% of building valuation <u>Expansion Area</u> : 15% of building valuation	Apply on a square foot basis (no specific amount recommended)	\$20 per square foot
Commercial			
Commercial Development	<u>Within City Limits & Expansion Area</u> : 2 affordable units per acre or 5% of building valuation	<u>Other Non-residential Uses</u> : \$2 to \$5 per square foot <u>Industrial Uses</u> : \$1 to \$4 per square foot	<u>Office, service, hotel, and retail uses</u> : \$5 per square foot <u>Industrial and Institutional Uses</u> : \$4 per square foot

DISCUSSION

1. Inclusionary Housing Ordinance

The City’s first Inclusionary Housing Ordinance was adopted in 1999 and since that time, the City has focused on ensuring that a percentage of all new housing units are affordable to income eligible households. Current [IHO requirements](#) can be met by 1) building affordable dwellings as part of a development project, 2) dedicating real property, improved or not, for development of affordable housing by the City’s Housing Authority or by a non- profit housing provider, 3) paying an in-lieu fee which is used to assist with the development of new affordable housing throughout the City, or 4) a combination of the above methods, to the approval of the Community Development Director.

To date, more than 1,201 deed-restricted or otherwise secured affordable dwellings have been planned for, entitled, or built since the adoption of the IHO in 1999. The City has granted, loaned, or committed \$10,785,954 of affordable housing in-lieu funds to assist with the development of 503 new deed-restricted affordable housing units.

2. 2020 Nexus Study

A priority identified in the 2019-21 Major City Goal work scope and action plan was to complete an Affordable Housing Nexus Study to evaluate the nexus between new commercial and residential development and the City’s requirements for affordable housing embodied in its Inclusionary Housing Ordinance ([SLOMC 17.138](#)). 2004 was the last time a similar study was completed.

A nexus study is necessary to establish the relationship between market-rate residential development and non-residential development and the need to support and construct new deed-restricted affordable housing in the City. The nexus study analyzed if new market-rate residential and non-residential development in the City increased demand for affordable housing and included an analysis on the historical performance of the City's IHO program.

On [April 21, 2020](#), the City Council received the [2020 Affordable Housing Nexus Study](#) completed by consultant David Paul Rosen and Associates (DRA). The Study determined that both residential and commercial development are inducing demand for affordable housing that is not being met by the housing market. The Study's findings verify that there is a nexus that justifies the City having an Inclusionary Housing Ordinance that applies to both residential and commercial development.

Nexus Study Recommendations

The Nexus Study provided several recommendations for updates to the City's existing Inclusionary Housing Ordinance. These recommendations are summarized below.

1. *Inclusionary Housing Ordinance (IHO) and Geographical Variation*. Based on comparable cities and an analysis of San Luis Obispo's economic/market data, the City should consider different requirements based on whether the residential project is for sale or rent and should discontinue differentiating between housing projects located within the City Limits and Expansion Areas.

Recommend City-Wide Affordable Housing Requirement for Residential Development as follows:

- Rental: 15% very low- and low-income units (5% very low income (50% AMI²) and 10% at low income (80% AMI))
- Owner: 15% low- and moderate-income units (5% at low income (80% AMI) and 10% at moderate income (120% AMI))

2. *Affordable Housing Standards*. The City should maintain its current definitions of affordable housing expense in terms of the percent of AMI used to calculate affordable rents and sales prices. In addition, the City should include utility costs as part of rent and Homeowners Association (HOA) fees as part of the affordable sales prices.

² Area Median Income. AMI's listed in the recommendations are maximums for the various income groups.

3. Project Size and Density Adjustments. The Study recommends eliminating project size and project density adjustments currently contained in Inclusionary Housing Ordinance [Table 2A](#) and recommends a minimum inclusionary requirement of one unit for projects of five or more units not otherwise exempt from the ordinance.
4. Residential In-Lieu Fees. The Study recommends applying in-lieu fees on a per square foot basis as the estimated economic equivalent of providing on-site units.
5. Non-Residential Nexus Fees (Commercial Development). The Study recommends fees in the range of \$1 to \$4 per square foot for industrial uses and \$2 to \$5 per square foot for other non-residential uses.

3. Inclusionary Housing Feasibility Analysis

In 2020 the City began work updating the Housing Element of the General Plan for the 6th Cycle Regional Housing Needs Allocation (RHNA). Based on the findings and recommendations of the Nexus Study and the need for additional affordable housing, the Housing Element Update included a new program (Program 2.13) to update the City's IHO.

In April 2021, the City hired Economic & Planning Systems, Inc. (EPS) to conduct a feasibility analysis based on the findings and recommendations provided by the Nexus Study. Over the last several months, staff has worked with EPS as they have analyzed the City's current IHO, current market conditions, and the Nexus Study and provided a preliminary recommendation based on the analysis outlined below. A more detailed discussion is provided as Attachment A – EPS Feasibility Memo.

EPS used separate methods of identifying appropriate fee levels for residential and commercial uses. For residential, EPS developed a feasibility model to compare different fee levels and inclusionary requirement scenarios and calibrated the inputs based on inclusionary programs in similar jurisdictions. The approach for defining the appropriate affordable housing commercial linkage fees was built off a similar exercise performed by DRA in the Nexus Study that relied on surveying commercial linkage fees in other jurisdictions.

It is important for the City Council and community to understand that financial feasibility is an important consideration because if the development of market-rate housing is not financially feasible for developers, then the amount of affordable housing accomplished through the Inclusionary Housing Ordinance will be minimal.

Residential Affordable Housing Analysis

EPS prepared financial proformas reflecting the expected costs of new development, based on the Nexus Study analysis, and compared those costs to the revenues that could be generated from the projects given various mixes of market-rate and affordable housing.

For Sale Units

In evaluating various inclusionary and impact fee scenarios for ownership housing, EPS analyzed the development economics of a hypothetical development consisting of 1,550 square foot, two-bedroom units, with an average of three persons per household.³ Seven scenarios were considered with this evaluation:

- Current Ordinance
- Current In-Lieu Fee
- No Inclusionary or Fee
- Maximum Nexus-Based Fee
- Maximum Feasible Fee
- Recommended In-Lieu Fee
- Feasible Inclusionary Requirements

Key revenue assumptions are based on RedFin sales data for San Luis Obispo over the period from December 2020 through December 2021. Data showed that a two-bedroom, 1,550 square foot unit could sell for around \$840,000. Affordable units, depending on the household income, could have a maximum home price between \$163,000 (very low) to \$405,000 (moderate). Construction cost estimates are based on assumptions used in the Nexus Study analysis, adjusted for inflation, with total direct and indirect costs (except affordable housing fees) assumed to be approximately \$650,000 per unit.

The seven scenarios test the feasibility of incorporating different fee levels and affordability requirements, with feasibility being measured by an estimated profit margin. Based on recent experience with developers and lenders in the region, EPS assumed that developers would require at least a 15 percent profit margin in order to accept the risk associated with the project. These revenue and cost estimates inform a range of profit margins (net revenue divided by gross revenue), which vary by scenario, as shown in Figure 1. The results show that the 'No Inclusionary or Fee' scenario yields the highest return, while all others, except the maximum nexus fee, also yield a return.

³ This prototype based on the average size of units analyzed in the Nexus Study analysis.

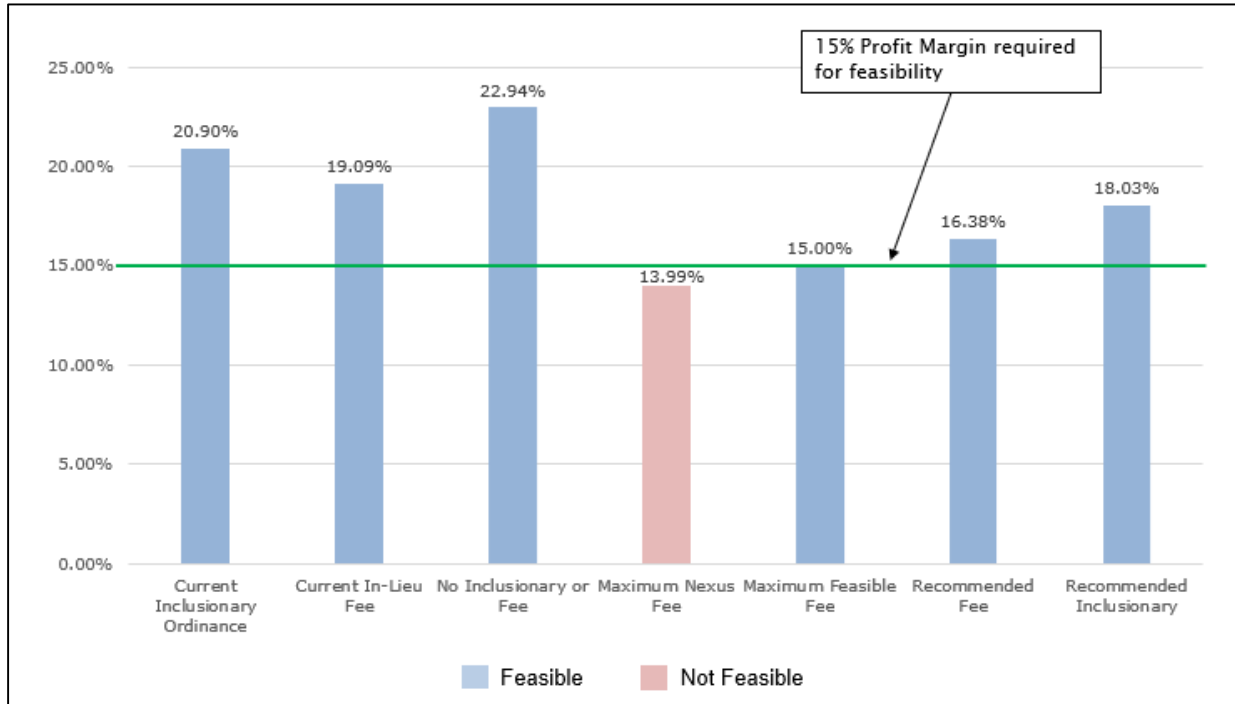


Figure 1: For-Sale Feasibility Results by Scenario

For Rent Units

In evaluating various scenarios for rental housing, EPS modeled a market rate multifamily development. Units are assumed to average 900 square feet with two bedrooms, and a household size of three people.⁴ Like the For Sale analysis, EPS evaluated seven scenarios:

1. Current Ordinance
2. Current In-Lieu Fee
3. No Inclusionary or Fee
4. Maximum Nexus-Based Fee
5. Maximum Feasible Fee
6. Recommended In-Lieu Fee
7. Feasible Inclusionary Requirements

For income assumptions, EPS compiled market-rate and affordable rents based on conditions and requirements in San Luis Obispo. As the standard metric for feasibility, EPS modeled the annual yield on cost, calculating aggregate Net Operating Income (NOI) divided by development costs. A 5 percent yield on cost was deemed the threshold for feasibility.

⁴ As with the for-sale scenarios, development costs are based on those used by the DRA analysis, adjusted for inflation.

Income assumptions for market rate units equal a NOI (revenue minus operational costs) of \$23,000 per year, or roughly \$2,900 per month in rent. This reflects typical rents for newly constructed multifamily in the Greater San Luis Obispo area. Affordable rents were informed by the [2021 income limits](#) for San Luis Obispo County, with the assumption that these households can spend up to 30 percent of gross income on housing. On the cost side, EPS again relied on assumptions from the Nexus Study, adjusted for inflation. These revenue and cost estimates inform a range of yield on cost percentages, which vary by scenario, as show in Figure 2.

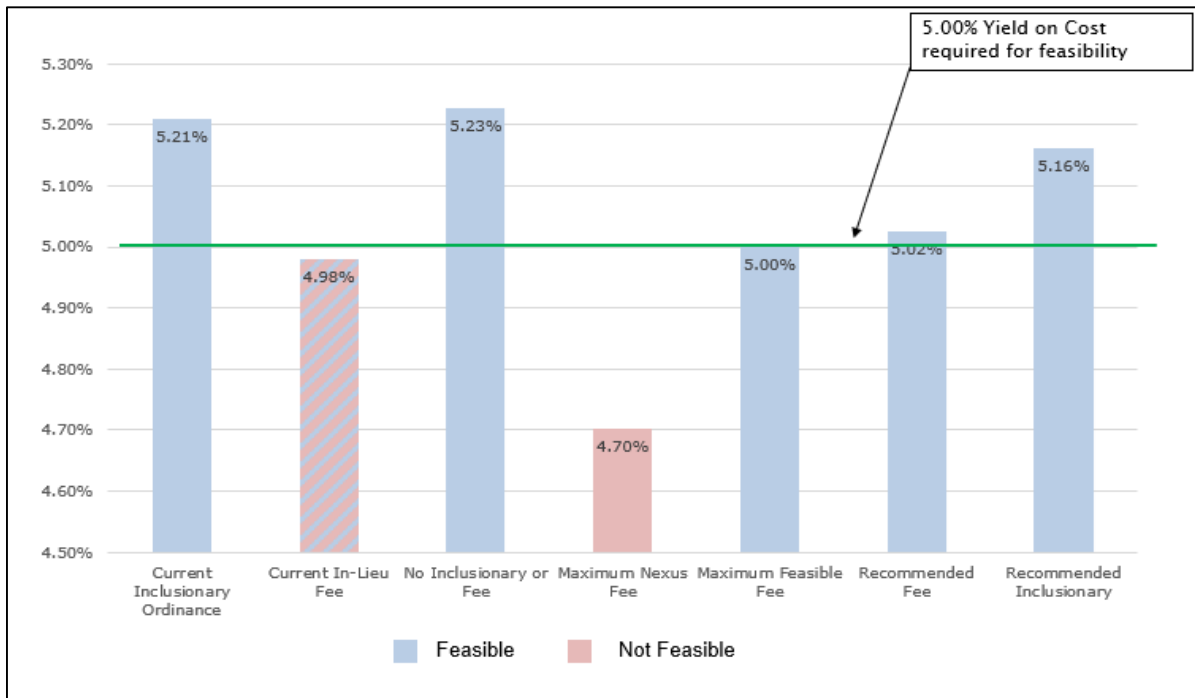


Figure 2: For-Rent Feasibility Results by Scenario

The results show that the current in-lieu fee is borderline infeasible, while the maximum nexus-based fee is not at all feasible. The remaining scenarios all appear to generate sufficient investment returns based on the assumptions used.

Commercial Development - Linkage Fee Calculations

In determining an appropriate commercial linkage fee level, EPS examined fee levels charged elsewhere in California. As noted in the Nexus Study, many cities within California do not currently include commercial fees as a part of their inclusionary housing requirements. Table 2 shows the commercial linkage fees by use (on a square foot basis) for Berkeley, Oakland, Petaluma, and San Luis Obispo County. Fees range from less than \$1 for industrial uses in San Luis Obispo County to \$5.90 for office and industrial uses in Oakland. Unsurprisingly, the Bay Area cities of Berkeley and Oakland have the highest commercial linkage fees, reflecting the higher cost of housing in the region.

Table 2: Commercial Linkage Fee Amounts in other California Jurisdictions

Jurisdiction	2021 Commercial Linkage Fee Amount					
	Office	Retail	Industrial	Hotel	R&D	Other Non-Res
Berkeley	\$4.50	\$4.50	\$2.25	\$4.50	\$4.50	-
Oakland	\$5.90	-	\$5.90	-	-	-
Petaluma	\$2.93	\$5.07	\$3.02	-	-	-
SLO County	\$2.46	\$2.11	\$0.98	\$2.11	-	\$1.84
City of San Luis Obispo	\$5.00	\$5.00	\$4.00	\$4.00	-	-

Sources: David Rosen and Associates; Keyser Marston Associates; City of Berkeley; City of Oakland; City of Petaluma; County of San Luis Obispo; Economic & Planning Systems, Inc.

Inclusionary Housing Ordinance Update Preliminary Recommendation

EPS is recommending several revisions to the City's existing affordable housing inclusionary program for new residential development and the introduction of a nexus-based commercial linkage fee for non-residential uses based on their feasibility analysis. Bulleted below are details of the preliminary recommendation and Table 3 provides a comparison between the City's current IHO, the Nexus Study and the preliminary recommendation.

Market-rate, for-sale residential development: 10 percent (split between low-income units (5 percent) moderate income units (5 percent)).

Rental residential development: 6 percent (split between very low-income units (3 percent) low-income units (3 percent)).

In-lieu fee: Developers opting to pay a fee rather than providing the units onsite as part of the development would pay an in-lieu fee charged per square foot (as opposed to a proportion of unit value) of \$25 for new for-sale housing and \$20 for new rental housing.

Commercial developments: EPS recommends a per square foot commercial linkage fee amount of \$5.00 for office, service, hotel, and retail uses, and \$4.00 for industrial and institutional uses.

Table 3: Comparison of the City’s Current IHO, the Nexus Study’s recommendation, and the preliminary recommendation based on EPS’ feasibility analysis.

	Current IHO*	Nexus Study Recommendation	IHO Update Preliminary Recommendation
Where the IHO applies	Requirements differ within City Limits and Expansion Areas	Same requirements Citywide	Same requirements Citywide
Table 2A Adjustments	Applies to projects that qualify	Remove	Remove
Residential			
For Sale	<u>Within City Limits</u> : 3% low or 5% moderate income <u>Expansion Area</u> : 5% low and 10% moderate income	15% (5% at low and 10% at moderate)	10% (5% low-income units and 5% moderate income)
For Sale In-lieu Fee	<u>Within City Limits</u> : 5% of building valuation <u>Expansion Area</u> : 15% of building valuation	Apply on a square foot basis (no specific amount recommended)	\$25 per square foot
For Rent	<u>Within City Limits</u> : 3% low or 5% moderate income <u>Expansion Area</u> : 5% low and 10% moderate income	15% very low- and low-income units (5% very low and 10% at low)	6% (3% very low-income and 3% low-income)
For Rent In-lieu Fee	<u>Within City Limits</u> : 5% of building valuation <u>Expansion Area</u> : 15% of building valuation	Apply on a square foot basis (no specific amount recommended)	\$20 per square foot
Commercial			
Commercial Development	<u>Within City Limits & Expansion Area</u> : 2 affordable units per acre or 5% of building valuation	<u>Other Non-residential Uses</u> : \$2 to \$5 per square foot <u>Industrial Uses</u> : \$1 to \$4 per square foot	<u>Office, service, hotel, and retail uses</u> : \$5 per square foot <u>Industrial and Institutional Uses</u> : \$4 per square foot

Table 4 provides some project comparisons of the implementation of the City’s current IHO and the preliminary recommendation.

Table 4: Project Example Comparison of the City’s Current IHO and Preliminary Recommendation.

Project	Number of Residential Units	Total affordable per Table 2	Total affordable per Table 2A	What the plans actually include	Total affordable per preliminary recommendation		
					For Rent (6%)**	For Sale (10%)**	Commercial (\$5/s.f.)
600 Tank Farm	280	23.38	1	8*	17	28	\$62,500.00
Bullock Ranch	184	28	7	7	12	19	N/A
950 Orcutt	78	4	1	1	5	8	\$34,000.00
2800 Broad	20	1.22	1	Paid fee	2	2	\$39,090.00
1030 Orcutt	15	0.98	1	1	1	2	\$8,570.00
2120 Santa Barbara	69	3.28	1	Paid fee	5	7	\$15,000.00

*Negotiated more units with the GP and Zoning amendment request

**Rounded to the next whole number

Study Session Discussion Items

Staff is requesting feedback from Council on three items: 1) fractional units, 2) the removal of Table 2A, and 3) calculating total number of inclusionary units based on land use rather than zoning.

Fractional Units

The City’s current IHO requires that fractional units (i.e., the inclusionary requirement results in a non-whole number of affordable units) be rounded up to the nearest whole number of units. Table 5 shows how this is applied to residential projects with various numbers of units.

Table 5: Results of rounding to the next whole number on different sized residential projects

No. of Units in Project	Total affordable per preliminary recommendation		Rounded up to next whole number		% of Project Affordable (based on whole numbers)	
	Rent (6%)	For Sale (10%)	Rent (6%)	For Sale (10%)	Rent (6%)	For Sale (10%)
6	0.36	0.60	1	1	16.67	16.67
12	0.72	1.20	1	2	8.33	16.67
15	0.9	1.50	1	2	6.67	13.33
18	1.08	1.80	2	2	11.11	11.11
20	1.2	2.00	2	2	10.00	10.00
24	1.44	2.40	2	3	8.33	12.50
30	1.8	3.00	2	3	6.67	10.00
43	2.58	4.30	3	5	6.98	11.63
50	3	5.00	3	5	6.00	10.00
73	4.38	7.30	5	8	6.85	10.96
100	6	10.00	6	10	6.00	10.00
141	8.46	14.10	9	15	6.38	10.64
200	12	20.00	12	20	6.00	10.00
333	19.98	33.30	20	34	6.01	10.21
500	30	50.00	30	50	6.00	10.00

The highlighted examples in Table 5 show that rounding to the next whole number results in smaller projects having a higher percentage of affordable units as compared to those projects with more units. It should be noted that smaller projects are likely to qualify for a density bonus just by meeting our inclusionary housing requirement and that this issue may be partially mitigated by building more market rate units. There are a few ways that the City could address fractional units.

1. The current requirement could be retained, and all projects would be required to round up no matter the fractional unit; or
2. If requirements result in less than one affordable unit or fractions of units (i.e., 10% of a 14-unit rental project = 1.4 affordable units), an applicant may pay the in-lieu fee for those fractional units or round up and provide the unit. The applicant may treat the fractional unit as Moderate; or
3. Apply option #2 to a certain size of residential projects (e.g., only residential projects that contain 20 units or less).

During the study session, City staff would like the Council to discuss and provide direction regarding how to address fractional units.

Table 2A

One of the biggest proposed changes to the IHO is the elimination of Table 2A. This proposal is consistent with HE Program 2.13⁵. Table 2A was established as a part of the IHO to encourage the development of projects with higher density and smaller unit sizes, that would be considered affordable-by-design within the City. Table 2A has been very successful in achieving this goal, however, as noted in the EPS’ Feasibility Memo, Table 2A is no longer achieving affordability in the current market. The feasibility analysis found that under current market conditions, smaller units are not affordable, even for moderate-income households. During the study session, City staff would like the Council to discuss and provide direction regarding the removal of Table 2A.

Zoning vs. Land Use

The preliminary recommendation also proposes that inclusionary requirements be calculated based on the land use, rather than the zoning of the site. Table 6 provides recent examples of projects that are located on commercially zoned properties. The City’s current IHO calculates the required number of units based on acreage and then allows that number to be adjusted based on Table 2A. The preliminary recommendation would calculate the number of affordable units based on number of total residential units *and* the square feet of commercial space proposed for the project. The preliminary recommendation more accurately captures the housing needs based on the actual uses proposed as part of the project. During the study session, City staff would like the Council to discuss and provide direction regarding the calculation of inclusionary housing requirements based on land use rather than zoning.

Table 6: Examples of housing projects located on commercially zoned properties

Project	No. of Units	Acres	Square Feet	Current IHO Affordable Unit Total		Preliminary Recommendation Affordable Unit Total		
				Table 2 ^a	Table 2A ^b	For Rent (6%) ^c	For Sale (10%) ^d	Commercial (\$/s.f.) ^e
600 Tank Farm	280	11.69	12,500	23.38	1	16.8 (17)	28	\$62,500.00
650 Tank Farm	249	9.89	18,600	19.78	1	14.94 (15)	24.9 (25)	\$93,000.00
2800 Broad	20	0.61	7,818	1.22	1	1.2 (2)	2	\$39,090.00
1030 Orcutt	15	0.49	1,714	0.98	1	0.9 (1)	1.5 (2)	\$8,570.00
2120 Santa Barbara	69	1.64	3,000	3.28	1	4.14 (5)	6.9 (7)	\$15,000.00
950 Orcutt	78	2.00	6,800	4	1	4.68 (5)	7.8 (8)	\$34,000.00

a) Total number of affordable units is based on 2 units per acre as required in Table 2 for commercially zoned properties.

⁵ HE Program 2.13: Update the Inclusionary Housing Ordinance, including Table 2A, based on findings and recommendations in the 2020 Affordable Housing Nexus Study and conduct further feasibility analysis in order to evaluate the City’s ability to provide affordable housing in the proportions shown in the Regional Housing Needs Allocation, per Policy 2.4.

- b) Adjusted total of affordable units based on Table 2A.
- c) These numbers reflect if the residential units are all rental.
- d) These numbers reflect if the residential units are all for sale.
- e) These numbers reflect if all the commercial spaces were being used for office, service, hotel, and retail uses.

HouseKeys is Under Contract to Perform Services as the City’s “Below Market Rate (BMR) Housing Administrator”

In 2021, the City of SLO issued construction permits for over 100 BMR units. The City’s program is growing, and at the same time, oversight and enforcement at the State level is ramping up to ensure local affordable housing programs comply with State law. In 2020, recognizing the growing challenges of in-house administration of the City’s Affordable Housing Inventory, the City Council authorized an RFP for a BMR Housing Administrator. HouseKeys was the successful firm through the RFP process and the City entered into a contract with HouseKeys on August 4, 2021 and began the onboarding process (please see Housekeys contract in Attachment B).

Having a contract program administrator is a departure from past City practice and staff have engaged the community over recent months to introduce HouseKeys and help clarify program expectations as part of the onboarding process. One of the core features of the BMR is that they are expected to act as the City’s agent in all BMR transactions. During the onboarding process, staff has received input regarding concerns that members of the mortgage and real estate community have about the exclusive role that HouseKeys will play with respect to BMR transactions involving the City.

Program History

Historically, the local ecosystem of loan officers, real estate agents, housing counselors, community organizations, and homebuilders has played an important role in the process of connecting eligible households with affordable housing units. The principal functions of the program were accomplished, as follows:

1. HASLO or PSHHC would perform income certifications for eligible households.
2. Developers would market and identify eligible buyers of their choosing, sometimes through a lottery depending on the number of units for sale.
3. A limited number of realtors and mortgage lenders who understand how the City’s deed restrictions work would engage with eligible buyers and help them through the transaction process.
4. City staff would work with income certified households by providing all the necessary paperwork for the City’s Deed of Trust and Promissory Note, which is a part of every BMR transaction.
5. City staff would work with owners and their mortgage brokers on refinancing requests.

6. City staff would work with owners and their real estate agents on resale requests, including working with the buyer when the unit is being sold to another income eligible household.

Program Direction and Benefits

This process was manageable when the total number of units in the City's inventory was smaller. However, this decentralized method of administration also has had significant drawbacks. The onboarding of HouseKeys is expected to allow the City to effectively scale its program up while providing significantly enhanced benefits to the City and community in the form of program compliance, customer service, and implementation of best practices. A summary of these benefits follows.

- **Transparency:** The regulatory landscape, and the oversight from the state has changed with increasing scrutiny and oversight. Maintaining program transparency and accountability on all levels including marketing, procurement, transactions, and accounting is required. HouseKeys will maintain an active eligible buyer list to match buyers with available housing units. Every transaction is audited and verified for compliance with State Housing and Community Development (HCD) criteria.
- **Efficiency:** HouseKeys is a company with 29 employees that provides similar BMR administration services to jurisdictions throughout California. This allows the City's program to scale up without adding staff who do not have the particular specialties needed to run an effective program of this scale in house.
- **Accountability and Compliance:** HouseKeys will perform annual compliance checks to ensure that City affordable housing units continue to be occupied by eligible households in compliance with City requirements and State law. In addition, HouseKeys will operate a training program and maintain lists of eligible mortgage brokers and real estate agents that are trained and authorized to work within the City's program. Finally, HouseKeys will engage with HCD regarding any enforcement actions or compliance audits.
- **Equity and Inclusion:** One of the most important features of the BMR role and HouseKeys' service is the fact that the City will finally have an outward facing presence to market its program and available affordable housing units throughout the region. A short-coming of the City's program to date is that the process of connecting eligible buyers to available units is opaque. Best practices for marketing affordable housing units include robust advertising and minimum time on market for every unit to give eligible buyers the opportunity. Where multiple eligible buyers exist, a lottery is normally the best way to ensure equity. Going forward, these are functions that will be accomplished by HouseKeys.

Item 6b

- **Customer Service:** Finally, the BMR role allows the City to provide excellent customer service to owners and occupants of homes within the City's inventory. HouseKeys will maintain an online portal that will allow owners to register their units and submit questions or requests for assistance at any time. Whether a property owner wants to sell, refinance, or just has questions about the status of their unit, that information will be readily available whereas City staff is limited in its ability to help with such requests.

Program Costs

Formal administration of the City's BMR housing program comes at a cost. The City will pay an annual fee to HouseKeys that is covered within the budget of the Community Development Department. For the cost of less than one FTE, the City is now able to reassign work to its Housing Coordinator to focus on high priority initiatives and projects, while gaining the work of a 29-member team to support BMR administration functions.

Concerns raised by members of the community primarily center around the HouseKeys business model and their fee schedule (please see Attachment C for responses to inquiries posed by Ms. Donna Lewis). As an agent of the City, HouseKeys intends to charge customary fees associated with the various transactions it will manage as outlined in their contract. During the onboarding process, HouseKeys has reached an agreement to administer the Avila Ranch affordable housing plan on behalf of the City. Now that HouseKeys is on board, all new projects with an affordable housing component will be required to work through HouseKeys to accomplish program compliance.

Revenues earned by HouseKeys, a for-profit company, come from its fee schedule and the transaction fees paid by buyers, sellers and homeowners in the program. In many respects, HouseKeys' fee schedule represents costs that are currently experienced by the City, builders, owners and sellers, however, they are simply absorbed instead of clearly identified. HouseKeys fee schedule and their ability to earn revenue in the program will be assessed on an ongoing basis. It is important to note that if the City and community are not satisfied with the work performed by HouseKeys, the City has every right to find another BMR Housing Administrator for its program. For this reason, staff is recommending that the updated Inclusionary Housing Ordinance codifies the role and responsibilities of a BMR Administrator.

Housekeys approach to BMR administration is particularly attractive to the City because it provides a cost structure to manage the whole affordable housing lifecycle, including HCE oversight (See Summary of management steps in the Affordable Housing Lifecycle in Attachment D). In this way, HouseKeys uses its fee schedule for cost recovery, as well. For example, fees related to the City's BMR homeownership program also support Housekeys ability to manage the City's BMR rental program at a highly competitive cost to the City.

Program Process including Procurement

Finally, formalizing a BMR Housing Administrator allows for responsiveness to a changing landscape for affordable housing providers. Income certifications, a service historically provided through HASLO, is no longer available. PSHHC is currently providing this service on a temporary basis until an Administrator takes over the service. Going forward, Housekeys will perform the service with all associated costs built into their fee for services.

The procurement process includes how buyers are introduced to the program and how the program is operated. Standardization is critical for transparency, to meet program goals of equity and inclusion, and accountability and monitoring, and to ensure that there is a fair process for all prospective buyers and renters, properties are priced properly, and that buyers can afford the housing payment according to HCE criteria.

Lastly, the Program Administrator will ensure that all parties involved (real estate agents, lenders, etc.) know how to comply with the program with a third-party to provide oversight and better customer service.⁶ One example of anticipated improvement is transparency of procurement that includes monitoring and enforcement of Section 17.138.130 “Eligibility Screening” in the City’s current Inclusionary Housing Ordinance that requires:

*The housing authority or other housing provider designated by the city shall screen prospective renters or buyers of affordable units. Renters or buyers of affordable units shall enter into an agreement with the city. Occupants must be selected by means of an **open, public process** which ensures that individuals of a group of interested participants have equal probability of selection. Private selection of individuals by project owners is not permitted for any affordable units.*

Next steps and expectations for program administration

Staff and Housekeys will continue community engagement for the BMR Housing Administration Program in concert with the Inclusionary Housing Ordinance update and ensure the update will provide additional clarity regarding the requirement and obligation for administration of BMR housing units over the entire affordable housing lifecycle with the defined role of program administrator. Staff is recommending that the updated IHO include the following provisions with respect to the IHO BMR.

⁶ Management of an approved vendor list includes creating a fair process to get on the list, hosting group and 1-on-1 trainings, creating content, updating materials, and fielding input from the public as complaints arise about response from individual providers. The annual fee is used both to contribute to costs and to establish commitment by the professionals who are on the list.

1. Purpose.
2. Definitions.
3. Applicability.
4. Program Administration Costs.
5. Duties of Program Administrator.
6. Default, Foreclosure, and Loss of Unit.
7. Annual Report.

Additionally, staff will work with Housekeys to update the City's administrative procedures and supporting documentation consistent with industry best practices. This work effort is described below. Staff is requesting concurrence from the City Council on these next steps.

- Update templates for Affordable Housing Agreements that include procedures for working with the Program Administrator with the following approximate language:

“The City may either handle in-house or contract responsibility for administration for the BMR Housing Program and monitoring compliance with the requirements to a Program Administrator pursuant to an Agreement executed between the City and the Administrator”.

- Update the City's Purchasing and Rental Guidelines to clearly reflect fees and procedures of the Program Administrator including underwriting, eligibility and compliance, as well as refinements to ensure procedures are consistent with state law and program goals.
- Produce Rental Compliance Guidelines (Tenants, Property Managers) and First-Time Homebuyer Loan Program Guidelines.
- Update the City's Affordable Housing Standards to reflect state guidance on standardized price calculations⁷. These standards are updated by staff on an annual basis ever July based on state area median income numbers for our area. Additionally, specific updates to standards are required to implement Housing Element Program 2.10 that states:

Update the Affordable Housing Standards to include Homeowners' Association (HOA) fees and a standard allowance for utilities in the calculation for affordable rents and home sales prices within two years of adopting the Housing Element.

⁷ Updated City Affordable Housing Standards will include State Law Calculations of a max 30% x 70% for "Low" and a range from 28-35% x 110% for "Moderate".

- Finally, City staff will work with the City Attorney's office and Housekeys to update the City's Equity Share program. The Equity-Share program has become more popular by developers but needs further evaluation to ensure compliance and consistency with the intent of the program.⁸

Previous Council or Advisory Body Action

- City Council received the 2020 Affordable Housing Nexus Study on April 21, 2020. The item was submitted as a "receive and file" and no action was taken.
- On May 4, 2021, the City Council authorized an RFP to solicit outside consultant expertise to oversee BMR housing administration, including ownership and rental units, and administration of the City's First- Time Homebuyer Loan program.⁹

Policy Context

The Housing Element was updated in 2020 and included Program 2.13 that specifically states that the City will update the IHO based on the findings and recommendations of the 2020 affordable Housing Nexus Study.

Program 2.13: Update the Inclusionary Housing Ordinance, including Table 2A, based on findings and recommendations in the 2020 Affordable Housing Nexus Study and conduct further feasibility analysis in order to evaluate the City's ability to provide affordable housing in the proportions shown in the Regional Housing Needs Allocation, per Policy 2.4.

Public Engagement

City staff and Housekeys have engaged with community members regarding BMR housing administration in recent months in the forums described below:

- Developers' Roundtable meeting on December 9, 2021.
- City Staff question and answer with interested parties from the real estate and lending community and stakeholders from the Developer Roundtable on January 11, 2022.

⁸ The Equity Share program allows flexibility for properties to sell at market rate , thus removing an affordable unit from the City's inventory and the program update will need to include evaluation of formulas to ensure appropriate recapture of the City's principal and interest to adequately support the construction of future affordable housing units.

⁹ May 4, 2021 Council Agenda Report [Item 11 - Authorization to issue a RFP for a Below Market Rate Housing Program Administrator \(slocity.org\)](#)

Item 6b

- Housekeys Meet and Greet #1 with Affordable housing partners (including HASLO, PSHH, and Habitat for Humanity and Transitions Mental Health Association) on January 13, 2022.
- Housekeys Meet and Greet #2 with Developers (including the Developers Roundtable, Home Builders Association, SLO Chamber and REACH) on January 27, 2022.
- Housekeys Meet and Greet #3 with Lenders and Real estate professionals (including professionals who have engaged with the City's Affordable Housing program and the SLO Coastal Association of Realtors) on February 3, 2022.
- Housekeys various direct engagement upon request with developers and real estate professionals.

This Study Session kicks off public outreach for the IHO update. Staff will be reaching out to stakeholders and the community regarding the IHO preliminary recommendation. Updates to the IHO will be refined based on public feedback before moving onto the Planning Commission and City Council for final review.

STUDY SESSION QUESTIONS:

The following study session questions are suggested for Council's consideration:

1. Fractional units: should applicants be required to round up no matter the fractional unit; or pay the in-lieu fee for fractional units and if so, should it be applicable to smaller projects (e.g. 20 units or less).
2. Table 2A: should Table 2A be removed from the IHO.
3. Land use vs. Zoning: should the total number of inclusionary units be calculated based on land use rather than zoning.
4. Formalization of Administrator: should the IHO include codification of the role of the BMR Housing Administrator.
5. Administrative documents: authorize the City Manager to approve updates to the City's affordable housing guidelines, administrative templates, equity share procedures, and supporting documentation.

ENVIRONMENTAL REVIEW

This item is provided as part of a study session and intended to provide information and involves no action by the City Council. As such, the California Environmental Quality Act (CEQA) does not apply.

FISCAL IMPACT

Budgeted: Yes

Funding Identified: Yes

Budget Year: 2021-23

Fiscal Analysis:

Funding Sources	Total Budget Available	Current Funding Request	Remaining Balance	Annual Ongoing Cost
General Fund	\$	\$	\$	\$
State				
Federal				
Fees				
Other:				
Total	\$	\$	\$	\$

The IHO update is part of the 2021-23 budget with funding provided by a \$283,000 Regional Early Action Planning (REAP) state grant.

The \$111,000 BMR administration contract, for year 1 and \$96,000 for Year 2 was approved as part of the 2021-23 financial plan.

ALTERNATIVES

1. ***Continue consideration of the Inclusionary Housing Preliminary Recommendation.*** Although no action is recommended in association with this recommendation, the City Council could ask staff to return during a future meeting to present additional information.
2. ***Continue consideration of the Below Market Rate Administration.*** Although no action is recommended in association with this recommendation, the City Council could ask staff to return during a future meeting to present additional information.

ATTACHMENTS

- A - EPS Feasibility Memo – includes a feasibility analysis and a Preliminary Recommendation of proposed changes to the City’s current Inclusionary Housing Ordinance
- B - Houskeys Contract
- C - Responses to Inquiries by Ms. Donna Lewis
- D - Summary Management Steps in the Affordable Housing Lifecycle