

Overview of Rental In-Lieu Fee Update Process

(updates occur every five years)

Step 1: Market Rate Rents

Identify average rents, unit size and bedroom mix for most recently built 3,000 market rate apartments.

Step 2: Affordable Rents

Determine affordable rents by income level weighted to reflect the same bedroom mix as the market rate units in Step 1.

Step 3: Affordability Gap

The affordability gap represents the estimated cost of setting aside a unit as affordable. The calculation is based on the difference between market rate and affordable rents in each income category divided by a capitalization rate⁽¹⁾.

Step 4: In-Lieu Fee

The in-lieu fee is reflective of the cost of providing affordable units at the 20% level applicable to the off-site alternative expressed on a per square foot basis. The affordability gap is multiplied by the off-site affordable unit requirement for each income category and divided by the average unit size to convert to a per square foot basis. Results for each of the three income categories are added to calculate the total in-lieu fee.

Step 5: Adjusted In-Lieu Fee for Projects Providing On-Site Units

When projects provide at least 5% Inclusionary Units on-site, an adjusted in-lieu fees applies based on the cost of providing affordable units at the 15% level applicable to the on-site alternative and reduced through application of two factors:

1. *Affordability Percentage for on-site units* - this factor represents the portion of the adjusted in-lieu fee which is not owed because the units are provided on-site.
2. *On-Site Adjustor* - this factor reduces the adjusted in-lieu fee as an incentive for projects to provide Inclusionary Units on-site.

(1) Capitalization rate or "cap rate" is a percentage relating market value to annual net income. Here it is applied to estimate the value forgone in making a unit affordable.

Supporting Information for Rental In-Lieu Fee Update Process

The supporting data, calculations, and further description of each step in the determination of the proposed in-lieu fee are presented below. Calculations would be updated every five years.

Step 1: Market Rate Rent for Most Recently Built Apartments in San Jose

Identify the average effective rents, unit size and bedroom mix for properties that include the most recently built 3,000 market rate apartments in San Jose. Use data from market data provider CoStar. Include apartment properties beginning with the most recently built until at least 3,000 units are represented. Do not include affordable units or projects for special populations such as seniors. Weight averages based on number of units.

Address	Year Built	No. Units	% Studios	% 1-Bed	% 2-Bed	% 3-Bed	Avg Net Unit SF	Avg Effective Rent Per Month
130 Stockton Ave	2020	162	7%	41%	48%	3%	986	\$2,335
955 S 1st St	2020	50	0%	38%	62%	0%	982	\$2,718
5 E Reed St	2020	105	20%	70%	10%	0%	703	\$2,546
1785 Almaden Rd	2020	55	0%	36%	64%	0%	998	\$2,795
28 N Almaden Ave	2020	201	30%	35%	35%	0%	573	\$2,813
6670 Emergent Way	2020	301	7%	50%	44%	0%	952	\$2,547
171 W Julian St	2020	381	13%	51%	29%	7%	666	\$2,988
355 Sunol St	2020	269	26%	37%	37%	0%	847	\$2,452
919 S Winchester Blvd	2020	636	0%	72%	28%	0%	854	\$2,972
98 N 1st St	2019	190	22%	51%	28%	0%	853	\$2,595
138 Balbach St	2019	101	0%	62%	30%	8%	949	\$2,672
1501 Berryessa Rd	2019	551	7%	49%	40%	3%	929	\$2,583
Weighted Average			10%	53%	35%	2%	844	\$2,712

Source: CoStar 2021

Step 2: Affordable Rents

Affordable rents are based on the City's published schedule for Inclusionary Units minus the required utility allowance. Affordable rents are weighted based on the bedroom mix applicable to the market rate units from Step 1. The objective is to determine the affordable rents that would apply if the average market rate unit from Step 1 were an Inclusionary Unit. Affordability levels applicable to off-site units are applied.

	<u>Studios</u>	<u>1-Bed</u>	<u>2-Bed</u>	<u>3-Bed</u>
Bedroom Mix from Step 1	10%	53%	35%	2%
Gross Affordable Rents per City Affordable Rent Schedule				
80% AMI	\$1,982	\$2,266	\$2,548	\$2,832
60% AMI	\$1,486	\$1,699	\$1,911	\$2,124
50% AMI	\$1,238	\$1,416	\$1,592	\$1,770
Less: Utility Allowance	(\$92)	(\$100)	(\$129)	(\$157)

Affordable Rents Net of Utilities

80% AMI	\$1,890	\$2,166	\$2,419	\$2,675
60% AMI	\$1,394	\$1,599	\$1,782	\$1,967
50% AMI	\$1,146	\$1,316	\$1,463	\$1,613

Average Affordable Rent ⁽¹⁾
\$2,236
\$1,649
\$1,355

Sources: City of San Jose 2020 Affordable Rent Schedule applicable to Inclusionary Units. County Housing Authority 2020 utility allowances for gas heat, hot water and cooking, electricity and water.

(1) Weighted based on the bedroom mix for the market rate units determined in Step 1.

Step 3: Affordability Gap

This step calculates the Affordability Gap based on the amount by which market rate rent determined in Step 1 exceeds affordable rents from Step 2. The Affordability Gap is calculated by dividing the annual rent difference by a published capitalization rate. The result represents the estimated gap associated with providing the affordable units within the project.

	<u>80% AMI</u>	<u>60% AMI</u>	<u>50% AMI</u>
Difference Between Market Rate and Affordable Rent			
Market Rate Rents Per Month (Step 1)	\$2,712	\$2,712	\$2,712
Less: Affordable Rents Per Month (Step 2)	\$2,236	\$1,649	\$1,355
Rent Difference Per Month (positive amounts)	\$476	\$1,063	\$1,357
Rent Difference Per Year	\$5,717	\$12,759	\$16,279
Capitalization Rate ⁽¹⁾	4.50%	4.50%	4.50%
Affordability Gap [=Rent Difference / Cap Rate]	\$127,000	\$284,000	\$362,000

(1) Integra Realty Resources cap rate for Class A urban multifamily in San Jose published April 2020.

Step 4: In-Lieu Fee (for Projects not Providing On-Site Units)

The rental in-lieu fee is calculated by multiplying the affordability gap from Step 3 by the off-site affordable unit requirement for each income category and dividing by the average unit size from Step 1 to convert to a per square foot amount. Figures are rounded to the nearest whole number. The per square foot figures for each income category are added to determine the total in-lieu fee.

While, as updated, the fee calculates as \$68/SF, it is proposed to be set at \$43/SF for strong market areas and \$18.70/SF for moderate market areas consistent with the prior calculation and Council direction.

	<u>80% AMI</u>	<u>60% AMI</u>	<u>50% AMI</u>	<u>Total</u>
Affordability Gap Per Affordable Unit (Step 3)	\$127,000	\$284,000	\$362,000	
Inclusionary percentage requirement	5%	5%	10%	20%
Average Net Unit Size (Step 1)	844 sq ft	844 sq ft	844 sq ft	
Calculated In-Lieu Fee for Rentals (Per Net SF)	\$8 /SF	\$17 /SF	\$43 /SF	\$68 /SF
[= affordability gap X affordable unit % / unit SF]				
Proposed In-Lieu Fee for Rentals (Per Net SF)				
<i>Strong Market Areas</i>				\$43 /SF
<i>Moderate Market Areas</i>				\$18.70 /SF
Consistent with Council Direction in Nov. 2019				

Step 5: Adjusted In-Lieu Fees for Projects Providing at Least 5% Inclusionary Units

This step establishes adjusted in-lieu fees for projects providing at least 5% Inclusionary Units on-site. Application of an Affordability Percentage removes that portion of the adjusted in-lieu fee applicable to the affordable units provided on-site. Multiplying by an On-Site Adjuster reduces the adjusted in-lieu fees to incentivize projects to include units on-site. The On-Site Adjuster is initially selected such that the adjusted in-lieu fee in strong market areas is equal to the FY20-21 Affordable Housing Impact Fee rate of \$18.70 per square foot when 5% of units are provided on-site at 100% AMI. The On-Site Adjuster may be modified as part of periodic updates to help ensure incentives under the program continue to align with City objectives.

	Strong Market Areas	Other Areas
In-Lieu Fee Before Adjustment	\$43 /SF	\$18.70 /SF <i>(20-21 AHIF rate)</i>
Adjusted In-Lieu Fee With 5% of Units On-Site at 100% AMI		
Affordability Percentage for 100% AMI units	9.30%	9.30%
On-Site Adjustor	52.05%	30%
Adjusted In-Lieu Fee	\$18.70	\$11.87
[= (Full Fee) * (1-Affordability Percentage) * (1-On-Site Adjustor)]		
Adjusted In-Lieu Fee With 5% of Units On-Site at 60% AMI		
Affordability Percentage for 60% AMI units	39.53%	39.53%
On-Site Adjustor	52.05%	30%
Adjusted In-Lieu Fee	\$12.47	\$7.92
[= (Full Fee) * (1-Affordability Percentage) * (1-On-Site Adjustor)]		
Adjusted In-Lieu Fee With 5% of Units On-Site at 50% AMI		
Affordability Percentage for 50% AMI units	51.16%	51.16%
On-Site Adjustor	52.05%	30%
Adjusted In-Lieu Fee	\$10.07	\$6.39
[= (Full Fee) * (1-Affordability Percentage) * (1-On-Site Adjustor)]		

Overview of For-Sale In-Lieu Fee Update Process

(updates occur every five years)

Step 1: Market Rate Prices

Identify average prices, unit size and bedroom mix for attached market rate units built in last five years.

Step 2: Affordable Prices

Determine affordable sales prices weighted to reflect the same bedroom mix as the market rate units in Step 1.

Step 3: Affordability Gap

The affordability gap represents the estimated cost of setting aside a unit as affordable. The calculation is based on the difference between market rate and affordable prices.

Step 4: In-Lieu Fee

The in-lieu fee is reflective of the cost of providing affordable units at the 20% level applicable to the off-site alternative expressed on a per square foot basis. The affordability gap is multiplied by the off-site affordable unit requirement and divided by the average unit size to convert to a per square foot basis.

Supporting Information for For-Sale In-Lieu Fee Update Process

The supporting data, calculations, and further description of each step in the determination of the proposed in-lieu fee are presented below. Calculations would be updated every five years.

Step 1: Market Sales Prices for Most Recently Built Attached Units in San Jose

Identify the average market sales price, unit size and bedroom mix for new attached for-sale units built within the last five years and sold within the last two years in San Jose. Use data from market data provider CoreLogic.

Number of Bedrooms	No. of Sales	% of Sales	Avg Net Unit SF	Average Sales Price
One-Bedroom	4	1%	935	\$612,500
Two-Bedrooms	108	25%	1,229	\$819,394
Three-Bedrooms	269	62%	1,670	\$970,859
Four-Bedrooms	55	13%	2,113	\$1,060,264
Total / Average	436	100%	1,610	\$941,000

Source: CoreLogic 2021

Step 2: Affordable Sales Prices

Affordable sales prices are calculated based on the City's Inclusionary Housing Ordinance guidelines. Affordable sales prices are then weighted based on the bedroom mix applicable to the market rate units from Step 1. The objective is to determine the affordable sales price that would apply if the average market rate unit from Step 1 were an Inclusionary Unit.

	1-Bed	2-Bed	3-Bed	4-Bed	Average Affordable Sales Price ⁽¹⁾
Bedroom Mix from Step 1	1%	25%	62%	13%	
Affordable Sales Prices (110% AMI)	\$545,600	\$620,100	\$675,800	\$733,300	\$668,000

(1) Weighted based on the bedroom mix for the market rate units determined in Step 1.

Step 3: Affordability Gap

This step calculates the Affordability Gap based on the amount by which the market rate sales price determined in Step 1 exceeds the affordable sales price from Step 2. The result represents the estimated gap associated with providing the affordable units within the project.

Average Market Rate Price (Step 1)	\$941,000
Average Affordable Price (Step 2)	\$668,000
Affordability Gap [=Market Rate Price - Affordable Price]	\$273,000

Step 4: In-Lieu Fee

The for-sale in-lieu fee is calculated by multiplying the affordability gap from Step 3 by the off-site affordable unit requirement and dividing by the average unit size from Step 1 to convert to a per square foot amount and rounding to the nearest whole number. While, as updated, the fee calculates as \$34, it is proposed to be set at \$25/SF consistent with the prior calculation and Council direction.

Affordability Gap Per Affordable Unit (Step 3)	\$273,000
Inclusionary percentage requirement (off-site %)	20%
Average Net Unit Size (Step 1)	1,610 sq ft

Calculated In-Lieu Fee for For-Sale (Per Net SF)	\$34 /SF
[= affordability gap X affordable unit % / unit SF]	

Proposed In-Lieu Fee for For-Sale (Per Net SF)	\$25 /SF
Consistent with Council Direction in Nov. 2019	