Financial Analysis of Proposed Affordable Housing Program
City of Burlingame

For many years, new housing development in the Bay Area has not kept pace with the growing demand for housing. This is particularly true of San Mateo County, where strong economic growth has intensified housing demand, leading to rapid increases in home prices and rents. As a result, many local residents and workers are not able to afford housing in the County and the City of Burlingame.

The local jurisdictions within San Mateo County commissioned a coordinated set of residential nexus studies to help mitigate the impacts that new residential development has on the provision of affordable housing. Strategic Economics and Vernazza Wolfe Associates prepared the City of Burlingame Residential Impact Fee Nexus Study in 2015 (Nexus Study) as part of this countywide effort.

The Nexus Study evaluated development revenues (rents and sales prices), development costs and potential housing impact fees for the three most typical types of development in the City of Burlingame—single family attached, condominiums and apartments. The Nexus Study also performed a financial feasibility analysis of these three housing prototypes in order to develop recommendations regarding the feasible range of fees per square foot of residential development that the City could consider adopting. In general, the recommended fee levels in the Nexus Study for Burlingame range from $25 to $50 per square foot, while the maximum justified fee amounts according to the Nexus Study for Burlingame range from $50 to $85 per square foot, as shown below in Figure I-1 from the Nexus Study.

Figure I-1. Recommended Housing Impact Fees by Residential Prototype

Prototype	Maximum Justified Fee per Unit	Maximum Justified Fee per SF	Recommended Fee per Unit	Recommended Fee per SF
Single-Family Attached	$98,541	$52	$76,000 - $95,000	$40 - $50
Condominium	$91,598	$56	$41,250 - $82,500	$25 - $50
Apartments	$85,253	$85	$25,000 - $50,000	$25 - $50

Sources: Vernazza Wolfe Associates, Inc. & Strategic Economics, 2015

The City of Burlingame asked Seifel Consulting Inc. (Seifel) to prepare an updated financial analysis to help the City evaluate the potential adoption of new impact fees on residential development and the best strategies to incentivize the onsite provision of affordable housing within new development as part of the City's affordable housing program.

This report summarizes the findings from Seifel's financial analysis, which was initially presented to the City Council in July 2018. This report is organized into the following sections, which are accompanied by tables and charts as further described below:

A. Summary of Findings

This report presents the key financial considerations associated with achieving new residential development in the City of Burlingame and an updated development feasibility analysis to help the City evaluate how to incentivize the onsite provision of affordable housing within new development as part of its affordable housing program, which is proposed to include the adoption of housing fees on new residential development. The report concludes with potential policies that the City may want to consider implementing in order to encourage the provision of onsite affordable housing.

As rents and prices have continued to increase, the difference between the cost of housing and what many households can afford to pay for housing has increased, leading to a widening "affordability gap" for new housing. In order for new development to be financially feasible when including onsite affordable housing units, the cost of providing new affordable housing must be able to be factored into the total costs of developing housing while still leaving sufficient developer margin or return to allow development to go forward.

Developing infill housing development in Bay Area cities like Burlingame is typically challenging and risky to undertake given the uncertainties of the development process, and is costly due to the broad range of development cost factors discussed in this report. For example, land prices and construction costs (including parking) have risen rapidly in recent years, significantly affecting development feasibility for new housing, particularly for multifamily apartments where apartment rents have not been increasing as fast as construction costs.

Depending on the total development costs associated with new apartments, rental units may not yield sufficient returns to attract capital (creating a development feasibility gap). Higher density alternatives, however, are more feasible when land values are significantly less on a per unit basis, providing greater opportunities for developers to pay for public requirements such as affordable housing. Onsite affordable housing requirements that are focused on moderate income households (earning between 80% and 120% of Areawide Median Income) are more financially feasible and best correlate to citywide housing fee levels ranging from $15 to $25 per square foot on residential development. (This range of fee levels was tested in this financial analysis based on guidance from City staff, and takes into account housing fee levels in surrounding cities.)

Housing prices in the Bay Area have been increasing rapidly, and most buyers need significant cash or "trade-up" value in homes to afford new units, making it much more difficult for first-time homebuyers to purchase a new home. Constructing for-sale housing units is typically more financially feasible in Burlingame as compared to constructing apartments given the high prices for new homes. However, the affordability gap for new homes is significant, particularly for large single family attached units (townhomes). The financial analysis indicates that housing fees at $25/SF can be supported by new ownership development, and onsite affordable housing requirements focused on households between 110% and 135% AMI are financially feasible, assuming reasonable land and construction costs.

This analysis finds that the City of Burlingame may want to consider providing an onsite housing development alternative to the payment of housing fees that is primarily focused on addressing the housing needs of households earning between 80% and 135% Areawide Median Income and that requires the provision of 10 percent of total units as affordable housing units. For apartments, the provision of onsite housing is best accomplished with projects that provide a higher range of densities and have parking requirements similar to what is allowed in State Density Bonus Law for mixed income developments. For single family attached units, allowing affordable housing units to be a smaller size than what is typically built in single family attached developments significantly enhances the ability of developers to provide onsite housing units at affordable sales prices while maintaining development feasibility.

B. Infill Development Challenges and Opportunities

As described by the Urban Land Institute, the infill development process is complex and challenging but provides significant opportunities to create vibrant mixed-use neighborhoods.[1] As demand for urban living continues to increase, developers are increasingly undertaking new housing development that replaces or intensifies existing uses, often as part of mixed-use developments with housing above ground-floor retail or other commercial uses.

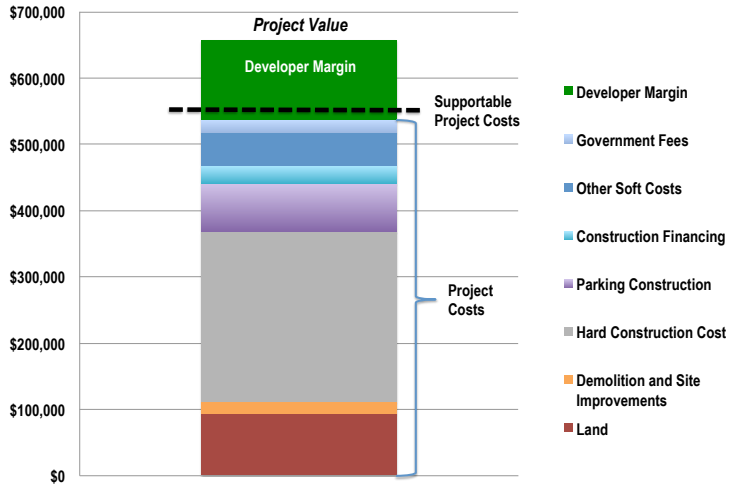
In order to develop new infill housing, developers must prepare a proposed residential development program, undertake a series of technical analyses, refine the development program based on input from a broad variety of stakeholders, and secure government approvals prior to starting construction. This pre-development period is typically the most risky phase of development, and developers typically need to raise private investor capital (equity) to fund pre-development costs.

Given the high risks associated with new development not occurring or not occurring as planned, developers must be able to generate sufficient returns or profit to attract private equity commensurate with these risks. Private equity must also be raised during the construction and the sales or lease-up period, as private lenders typically require a 35% to 40% equity contribution for infill housing projects.

Throughout the predevelopment process, and most importantly prior to initiating construction, a developer must be able to demonstrate to its private capital sources (private investors and lenders) that there is sufficient developer margin (return) to take into account potential risks and to repay capital at specified levels of return. In most capital structures, the priority of capital repayment is as follows: 1) construction and permanent lenders, 2) private investors who typically receive a preferred return and a share of profits that are generated by the development and 3) the developer.[2]

Figure B-1 below illustrates the development feasibility framework for new development, which shows the typical costs of development, the supportable project costs based on a target return, and the projected developer margin (or return) after taking into account all development costs.

Figure B-1
Development Feasibility Framework Per Residential Unit

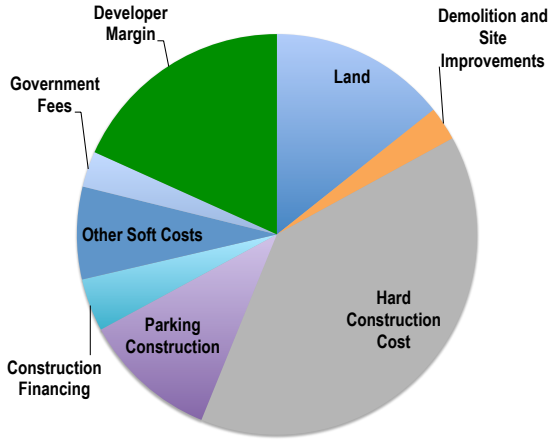


[1] https://urbanland.uli.org/development-business/making-infill-work-floridas-urban-cores/

[2] The developer is often allowed to receive a reimbursement for developer project management and overhead costs to manage the development process out of the construction loan proceeds.

Figure B-2 illustrates the typical development costs associated with infill development, which include the direct costs of new development (demolition costs, site improvement, parking, and building hard construction) and the indirect costs of new development (also known as soft costs, which include government fees, architecture and engineering, construction financing, and other soft costs).

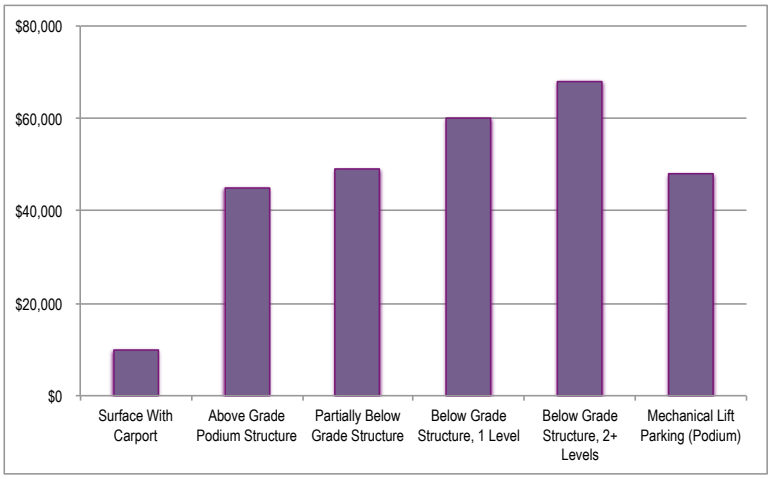
Figure B-2
Typical Development Costs for Infill Development



Building construction costs are the most significant cost component to developing housing. Residential building costs increase based on the type of construction, with wood-frame development (referred to as "Type V" construction) being the least expensive, and concrete/steel, fire-resistive development (referred to as "Type I" construction) being the most expensive on a per square foot basis. Most of the new residential development in Burlingame is Type V wood-frame construction built over a concrete podium slab with parking below, or underground parking.

Parking costs are a major contributor to residential construction costs as the costs of constructing a parking space within a building can range from $40,000 to $70,000 per space depending on the location of the parking and the site conditions, as shown in Figure B-3. (For example, the cost of building underground parking is higher in locations that require significant environmental remediation and/or have high water tables.) Requiring substantial amounts of ground floor retail space and associated parking also significantly increases costs.

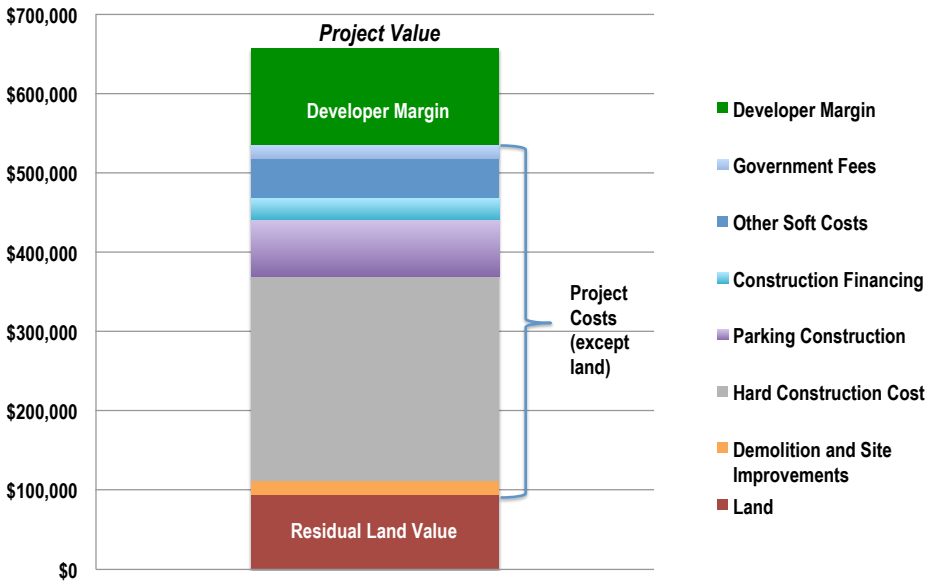
Figure B-3
Typical Parking Construction Cost Per Space



Residential construction costs have increased significantly since 2015 due to rapid increases in material costs (including lumber, concrete and steel) and robust demand for construction labor and subcontractors. Some construction experts report that construction costs on the Peninsula have annually increased between 10% and 15% over the past two to three years.

Land costs are also a major contributor to development costs, and they vary widely for infill development. Land costs are determined by the marketplace based on the price at which property owners are willing to sell their property and what developers can afford to pay for land after taking into account all non-land related development costs including a sufficient allowance for developer margin or return. This "residual" value of land for future residential uses (often referred to as "residual land value") must exceed the property's value given its current use. Figure B-4 below illustrates how developers typically calculate residual land value to determine how much they can afford to pay for property acquisition.

Figure B-4
Residual Land Value Per Residential Unit



Since most infill sites in Burlingame that might be developed as housing have existing buildings generating rental income, the developer must typically pay an amount that is significantly higher than the existing property value based on this rental income to incentivize the owner to sell. Some property owners require developers to purchase property outright, while others are willing to allow developers to pay for the opportunity to develop property in the future by entering into an option to purchase property.

Typically, land purchase options provide for a certain period of time during which a developer can undertake pre-development activities, and option payments typically increase over time, particularly if performance milestones are not met. At some point, most property owners require developers to purchase property outright or let the option expire if the pre-development process extends for a long time.

In summary, developing residential infill development is costly in cities like Burlingame and others on the Peninsula due to the following cost factors:

- Expensive property acquisition costs, particularly in areas of high demand such as Burlingame.
- Significant environmental mitigation and remediation costs.

- Public infrastructure and facility upgrades to accommodate new development.
- Complex governmental approval process that can take a long time to complete and can result in significant modifications to the development program and architectural design from what is originally proposed.
- Public fees for municipal costs related to land use planning, application processing, permits and public infrastructure/facilities (development impact fees).
- Higher cost of capital and investor return thresholds as projects take longer and often have unique project components that are more difficult to underwrite.
- Expensive construction costs due to the inclusion of structured parking (particularly underground parking) and the vertical integration of multiple uses with different design and construction requirements.

These development costs have rapidly increased in the Bay Area since 2015, making it much more difficult for residential infill development to be financially feasible than what was analyzed and reported in the Nexus Study.

Based on discussions with real estate professionals, infill development in the Bay Area is likely going to continue to be challenging to undertake for the following reasons:

- Despite the fact that the United States has experienced a very long economic expansion since the last recession, the Federal Reserve continues to think that the United States is still in a period of moderate economic expansion.[3]
- Interest rates have been at historic lows but are anticipated to continue to increase over time as evidenced by the recent interest rate increases by the Federal Reserve.
- Capitalization rates, which are used to measure property values, tend to increase over time as interest rates increase. As cap rates increase, underwriters typically lower their expectation of future property values.[4]
- Construction costs are anticipated to continue to increase given the high demand for construction, particularly given the rebuilding activity after the recent fires in California.
- Housing supply in the Bay Area is not keeping pace with demand. For example, in high employment growth, Bayside areas like San Mateo and Santa Clara counties, only one housing unit was built for every 15 jobs created between 2011 to 2015, according to the Metropolitan Transportation Commission.[5]
- Due to high housing demand, the housing affordability gap has widened for many households in the Bay Area.
- Apartment rent growth has flattened on the Peninsula, in part due to the housing affordability crisis, as many households cannot afford to pay higher market rate apartment rents.
- While moderate economic expansion is projected in the near term, an economic recession will likely emerge sometime in the next few years based on historical experience, which will significantly affect future housing development conditions.

[3] https://www.federalreserve.gov/newsevents/speech/powell20180406a.htm

[4] A capitalization rate is equal to the ratio of a property's net operating income to its purchase price or value. Low cap rates mean that properties are perceived by the market place to have a high value in relationship to their income producing potential.

[5] https://www.planbayarea.org/sites/default/files/san_francisco_cma_board_presentation.pdf

C. Current Development Conditions in the City of Burlingame

As described earlier, the Nexus Study evaluated development conditions in the City of Burlingame for the purpose of developing housing fee recommendations. The first step in the financial analysis was to review the Nexus Study in order to understand the core development assumptions and methodologies used in the Nexus Study for the three most typical types of development in the City of Burlingame—apartments, condominiums and single family attached units (townhomes).

City staff provided a variety of information and input regarding recent residential development in Burlingame for each of these residential types, including residential densities and development programs. Seifel also collaborated with The Concord Group to assemble residential market data for Burlingame and surrounding cities for the three housing types. Seifel interviewed developers undertaking projects in Burlingame and nearby cities in order to gather recent data regarding local development conditions, residential unit sizes, residential revenues, development costs and land prices.

In consultation with City staff, Seifel has evaluated the same three housing types and parcel sizes as previously analyzed in the Nexus Study, but the development characteristics for each prototype have been modified to reflect recent development experience in the City of Burlingame as follows:

- Multifamily apartments on a 3-acre site– three apartment scenarios have been analyzed at densities of 50, 70 and 120 dwelling units per acre (dua)
- Condominiums on a .5-acre site– one condominium (condo) scenario at 50 dua
- Single family attached (SFA) homes on a 1.7-acre site– one SFA scenario at 18 dua

Table C-1 below summarizes the key characteristics of each residential prototype.

Table C-1
Summary of Development Characteristics for Residential Prototypes

Building Characteristics	Apartments (50 dua)	Apartments (70 dua)	Apartments (120 dua)	Condominiums	Single Family Attached (For Sale)
Building Type	Wood-Frame	Wood-Frame	Wood-Frame	Wood-Frame	Wood-Frame
Total Residential Units	150	210	360	25	31
Residential Net Square Feet (NSF)	127,500	174,300	288,000	25,000	46,500
Average Unit Size (NSF)	850	830	800	1,000	1,500
Parking Type	Podium	Podium	Podium	Underground	Tuck-Under
Efficiency Factor [a]	70%	70%	70%	80%	85%
Residential Gross Square Footage (GSF)	182,143	249,000	411,429	31,250	54,706
Floor Area Ratio (FAR) [b]	1.4	1.9	3.1	1.4	0.7
Land Area (SF)	130,680	130,680	130,680	21,780	74,052
Land Area (Acres)	3.00	3.00	3.00	0.50	1.70
Units per Acre	50	70	120	50	18

Notes:
(a) Ratio of residential net square footage to residential gross square footage
(b) Floor area ratio (FAR) measures density by dividing residential gross building area by total site area
Source: The Concord Group, Seifel Consulting Inc.

1. Development Revenues

Revenues from new residential development are generated from the following sources:

- Rental revenues, which are generated by the monthly rental of apartments, and the associated market value of an apartment unit, based on this rental income.[6]
- Sale of residential units, either from the sale of single family attached homes or condominiums.

The Concord Group (TCG) assembled residential market data for the three housing product types for the City of Burlingame and surrounding cities in the northern part of San Mateo County as of May 2018. TCG gathered residential market data on apartments and for-sale communities in these areas to inform their analysis. Table C-2 below summarizes the anticipated revenues to be generated by the residential prototypes based on the residential market analysis prepared by TCG, which has been adjusted to reflect the typical unit mix being developed in Burlingame. (The supporting market data and analysis prepared by TCG is included in Appendix 1.)

Table C-2
Summary of Residential Revenues for Residential Prototypes

Prototype		Residential Net Square Feet (NSF)	Unit Sales Price/ Monthy Rent
Apartments (50 dua)			
Type V Wood Frame	Average	850	$3,734
50 units per acre	Total	127,500	
Podium			
Apartments (70 dua)			
Type V Wood Frame	Average	830	$3,651
70 units per acre	Total	174,300	
Podium			
Apartments (120 dua)			
Type V Wood Frame	Average	800	$3,569
120 units per acre	Total	288,000	
Podium			
Condominiums	Average	1,000	$939,000
Type V Wood Frame	Total	25,000	
50 units per acre			
Underground			
Single Family Attached (For Sale)			
Type V Wood Frame	Average	1,500	$1,632,000
18 units per acre	Total	46,500	
Tuck-Under			

Source: The Concord Group, Seifel Consulting Inc.

[6] The value of an apartment unit is based on standard appraisal valuation technique using capitalized net operating income (net operating income divided by an assumed cap rate for apartments).

a. Apartment Rents and Values

Monthly market rents for new apartments in Burlingame are anticipated to range between $2,300 for studios to about $4,600 for three-bedroom units. Based on a typical mix of units, average market rents for an apartment building with a typical 800-850 square feet average unit size are estimated to range from approximately $3,600 to $3,700 per month.

The potential value of an apartment unit is estimated by capitalizing the annual net operating income using a 4.25% capitalization rate (cap rate) for residential apartments and deducting sales-related expenses in order to project net apartment revenues for the financial analysis. Net operating income (NOI) is equal to project revenues less a 5 percent vacancy allowance less operating expenses (including property taxes). As described earlier, current cap rates are at historically low levels, and this low, 4.25% cap rate reflects the robust market conditions for housing on the Peninsula. Sales expenses are assumed at 3% of value and include sales/brokerage fees, title/recording fees and other sales related expenses.

b. Condominium and Single Family Attached Sales Prices

Sales prices for condominiums and single family attached units vary based on location, unit size, building amenities, and whether or not units have a view premium, among other factors. Sales prices for each housing prototype are based on anticipated sales value per net square foot (NSF) for a typical new development of comparable height, target market and unit size in developments located in or near Burlingame.

As the average size of units, design features and amenities typically differ between condominium and single family attached developments, the projected market pricing takes this into account. Condominium market sales prices typically range from $900 to $1,000/NSF, and the average price for condominium units has been assumed to be about $939,000. Single family attached units are typically higher priced, ranging from $1,000 to $1,100/NSF, and the average price for these units is projected to be about $1.63 million. (These sales prices are assumed to include the cost of parking.)

2. Development Costs

Development cost assumptions were developed based on a review of the prior Nexus Study assumptions and interviews with real estate professionals who are actively developing residential projects in the Peninsula. Development costs vary from project to project but generally consist of three major cost categories: land, direct costs to improve and construct buildings (also known as hard costs) and indirect costs that are required to prepare for development (also known as soft costs).

a. Land Costs

As described earlier, most residential infill sites in Burlingame have existing buildings that generate rental income. Given this, developers must typically purchase property at prices that are significantly higher than the existing property value based on this rental income to incentivize the owner to sell while maintaining development feasibility.

Property values in the City of Burlingame (and the Peninsula) vary widely depending on the existing use of the property and the future use of the property. Based on a review of market data compiled by TCG and interviews with developers, land values are assumed to range from $200 to $260 per square foot of land, or about $8.7 million to $11.3 million per acre. However, land costs may be much higher than this level, particularly when a developer is purchasing a commercial property that achieves high retail and office rents such as in downtown Burlingame.

For residential development, developers evaluate how much they can afford to pay for land based on the supportable residual land value per unit under alternative development programs assuming the ultimate value of the development is sufficient to support development costs and achieve sufficient developer margin or return thresholds to attract private capital. Developments that can achieve higher numbers of dwelling units per acre (du/ac) can spread the cost of land over a greater number of housing units, which typically improves development feasibility.

b. Direct Costs (Hard Costs)

Direct costs include all of the hard construction costs that are associated with new development.

- Demolition and site improvement costs include all of the costs that are required to ready the site for development, including the demolition of existing structures, completion of the environmental remediation work and the provision of public and private pathways and landscaped areas of the project.
- Building hard construction costs include the construction costs related to residential, parking and any ground floor retail uses.

Residential hard construction costs are based on wood-frame construction over podium or below-grade parking. All of the hard construction costs include costs related to general conditions plus general contractor (GC) overhead, profit, insurance and other GC costs. No additional hard cost contingency factor was assumed in this analysis.

c. Indirect Costs (Soft Costs)

Indirect costs include all of the soft costs that are associated with new development. These include government fees for planning, permitting and development impact fees, construction financing and other soft costs, such as professional services (architectural design, engineering, environmental studies, market analysis, legal, marketing, etcetera).

City staff provided estimates of the potential government fees that would need to be paid for each prototype to cover fees charged by the City, local School Districts and other public agencies. Developers use construction loans to finance a large share of the development costs during construction.
The construction financing assumptions take into account today's low-interest rate environment for construction loans and relatively conservative equity requirements. Other soft costs are based on representative percentages of hard construction costs based on a review of pro formas, interviews with real estate professionals and the prior Nexus Study.

Table C-3 below summarizes the projected development costs associated with each residential prototype based on these assumptions.

Table C-3
Summary of Development Cost Assumptions for Residential Prototypes

Development Costs		Apartments (50 dua)	Apartments (70 dua)	Apartments (120 dua)	Condominiums	Single Family Attached (For Sale)
Direct Costs [a]						
Buliding and Site Improvement Costs	per Unit	$382,000	$357,000	$347,000	$438,000	$675,000
Indirect Costs [b]						
Permits & Fees (Excl. Housing) [c]	per Unit	$18,500	$18,500	$18,500	$26,700	$27,800
Other Soft Costs	% of Direct Costs	16%	15%	15%	20%	20%
Financing Costs						
Loan to Cost Ratio (LTC)	% of Dev't Costs	65%	65%	65%	65%	65%
Loan Interest Rate		5.0%	5.0%	5.0%	5.0%	5.0%
Construction/ Absorption Period	in months	27	29	35	22	20
Outstanding Balance (Utilization Rate)	% of Dev't Costs	60%	60%	60%	60%	60%
Loan Fees	% of Loan Amount	1.5%	1.5%	1.5%	1.5%	1.5%

Note: Development costs are based on review of similar project pro formas in the Bay Area and interviews with developers, construction experts, other real estate professionals, and City staff.

(a) Direct costs include site work, building construction, and parking costs of $60,000 per space for underground parking and $45,000 per space for podium parking.

(b) Other soft costs include architectural and engineering fees (typically ranging from 5% for larger projects to 7% of direct costs for smaller projects), taxes, insurance, legal & accounting, developer project management and overhead, sales and marketing and other consultant services. The higher allowance of indirect costs for ownership housing is attributable to higher cost of sales, marketing and insurance costs. These costs depend on the size, complexity and time frame of the project, and these percentage estimates assume a streamlined design and approval process.

(c) Permits & fees were calculated by the City based on recent experience with similar projects and exclude proposed housing fees.

Source: Development pro forma data on comparable projects, interviews with real estate professionals, City of Burlingame, Seifel Consulting, Inc.

3. Developer Return Metrics

Developers, lenders and investors evaluate and measure returns in several ways. Based on input from real estate developers, equity investors and lenders, development returns are based on two key measures typically used by the real estate community: Developer Margin (or Return) and Yield on Cost.

a. Developer Margin or Return

Developer margin or return is equal to the difference between net potential revenues and total development costs (before consideration of developer return or profit). As described earlier, a developer will not proceed to build a project unless the project generates sufficient developer margin or return to warrant the risk and to attract the private capital investment needed to undertake the project.

Developers and investors use different target return on cost (ROC) thresholds depending on the level of complexity of the project, construction types, construction schedule, sales/rental absorption timeline, potential equity sources including the use of tax credits. Projects with longer timelines have higher risk and as a result require a higher return on cost.

The lowest return threshold for mixed income apartments is based on the allowable developer fee (or return) according to the relevant tax credit regulations used by the California Tax Credit Allocation Committee to implement Federal and State tax credit laws. These regulations allow a maximum developer fee for new construction 4% Low Income Housing Tax Credit projects that is equal to 15% of the project's unadjusted eligible basis, which is approximately 14% of total development costs. (The unadjusted eligible basis excludes land acquisition costs and a portion of other project costs.)

Market rate return (ROC) to attract private capital investment for market rate developments typically range from 15% to 25% on total development cost depending on the complexity, size and time frame for development, as well as whether the development is an apartment development, a for-sale condominium or a single family attached development.

b. Yield on Cost (also known as Return on Cost for Apartments)

The most important feasibility return metric for apartment developments is called Return on Cost or Yield on Cost (YOC). YOC is measured based on Net Operating Income (NOI) divided by development costs. (NOI is equal to project revenues less vacancy allowance less operating expenses.) Another important feasibility metric is the calculation of supportable project costs, which is calculated by dividing NOI by the YOC. If supportable project costs exceed total development costs (before consideration of developer return/profit), then the project is financially feasible.

While institutional investors and pension funds have typically underwritten projects to a YOC of between 5.5% to 6% in the Bay Area, recent trends indicate that some capital sources have accepted lower rates of return between 5% to 5.25% for residential development in high demand areas along the Peninsula. Based on these recent trends, the target YOC for apartments is assumed at 5.25% for this analysis, which means that apartment developments that achieve a 5.25% YOC are assumed to be financially feasible, while those below this threshold may not be able to attract the necessary capital to move forward, particularly if the YOC is well below a 5.0% YOC. YOC thresholds are expected to increase in the future as interest rates, cap rates and the cost of capital increases.

D. Financial Analysis of Housing Fee Alternatives

As described earlier, the City of Burlingame and all of the local jurisdictions within San Mateo County commissioned a coordinated set of residential nexus studies to help mitigate the impacts of new residential development on the provision of affordable housing. The City of Burlingame's Nexus Study recommended a range of housing fee levels from $25 to $50 per square foot, while the maximum justified fee amounts according to the Nexus Study ranged from $50 to $85 per square foot.

Other cities in San Mateo County have already adopted housing fees that are significantly lower than the maximum justified nexus amounts. Based on a recent survey of other jurisdictions in San Mateo County summarized by City staff, adopted housing fees ranged from $15 to $34 per square foot, with median fee levels at $21 per square foot, as shown below in Table D-1.

Table D-1
Summary of Housing Fee Levels of Other San Mateo County Jurisdictions

Jurisdiction	Townhomes Per SF	Condominiums Per SF	Apartments Per SF	Date Fee Adopted
Atherton	None			
Belmont	$20.00	$20.00	$20.00	2017
Colma	$15.00	$15.00	$15.00	2016
Daly City	$18.00	$22.00	$25.00	2014
East Palo Alto[1]	$23.00	$23.00	$33.71	2014
Foster City	None[2]			
Menlo Park	None[2]			
Pacifica	None[2]			
Portola Valley	None[3]			
Redwood City[4]	$25.00	$20.00	$20.00	2015
San Bruno	$25.00	$25.00	$25.00	2016
San Carlos[5]	$20.59	$20.59	$21.00	2010
San Mateo City	None[2]			
San Mateo County[6]	$12.50	$12.50	$10.00	2016
South San Francisco	None[2]			
LOWEST	$12.50	$12.50	$10.00	
AVERAGE	$19.89	$19.76	$21.21	
MEDIAN	$20.30	$20.30	$20.50	
HIGHEST	$25.00	$25.00	$33.71	

[1] Townhome and condo fee increases to $44.00/sf for projects with structured parking. Apartment fee increases to $44.72/sf for projects outside Ravenswood Business District.

[2] No Housing Impact Fee adopted, but Inclusionary Housing requires Below Market Rate units in new developments. Some municipalities allow on-site Below Market Rate units to be satisfied with in-lieu fees.

[3] Has inclusionary fee triggered by subdivisions.

[4] Fee applies to projects with between 5 and 19 units. Projects with 20 units or greater are required to provide Inclusionary units rather than fees. Projects with 4 or fewer units are not subject to fees or inclusionary requirements.

[5] Sliding scale: fees vary based on number of units, up to $42.20/sf for largest projects. Also assesses fee on single family additions.

[6] $5.00/sf for first 2,500 sf, $12.50 per each square foot over 2,500 sf. Only applies to projects with 4 or fewer units; projects with 5 units or more are subject to the Inclusionary Housing Ordinance rather than fees.

While housing fees could potentially be charged at higher levels in the City of Burlingame than other cities, this financial analysis evaluated alternative housing fee levels at $15, $20 and $25 per square foot (SF), reflective of the typical fee level ranges of other jurisdictions in San Mateo County.[7]

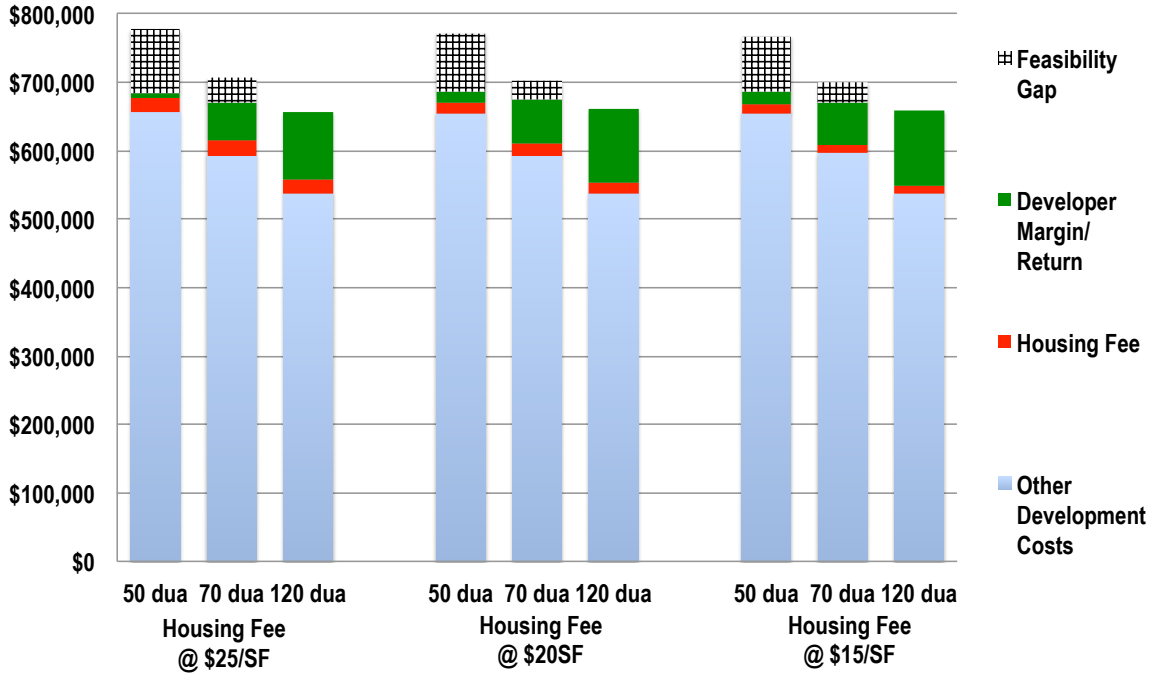
[7] This analysis assumes that housing fees would be calculated on a residential net square foot basis, which is typical fee framework, though some cities do calculate fees on a gross square foot basis.

1. Financial Analysis of Apartments at Varying Housing Fee Levels

The first step in the financial analysis was to analyze the potential financial impact from the adoption of housing fees ranging from $15 to $25/SF on apartments, as apartments have the potential to produce the greatest number of new housing units in Burlingame. Figure D-1 shows the effect on development feasibility of three potential housing levels on three apartment prototypes representing the range of densities currently being developed or proposed in Burlingame.

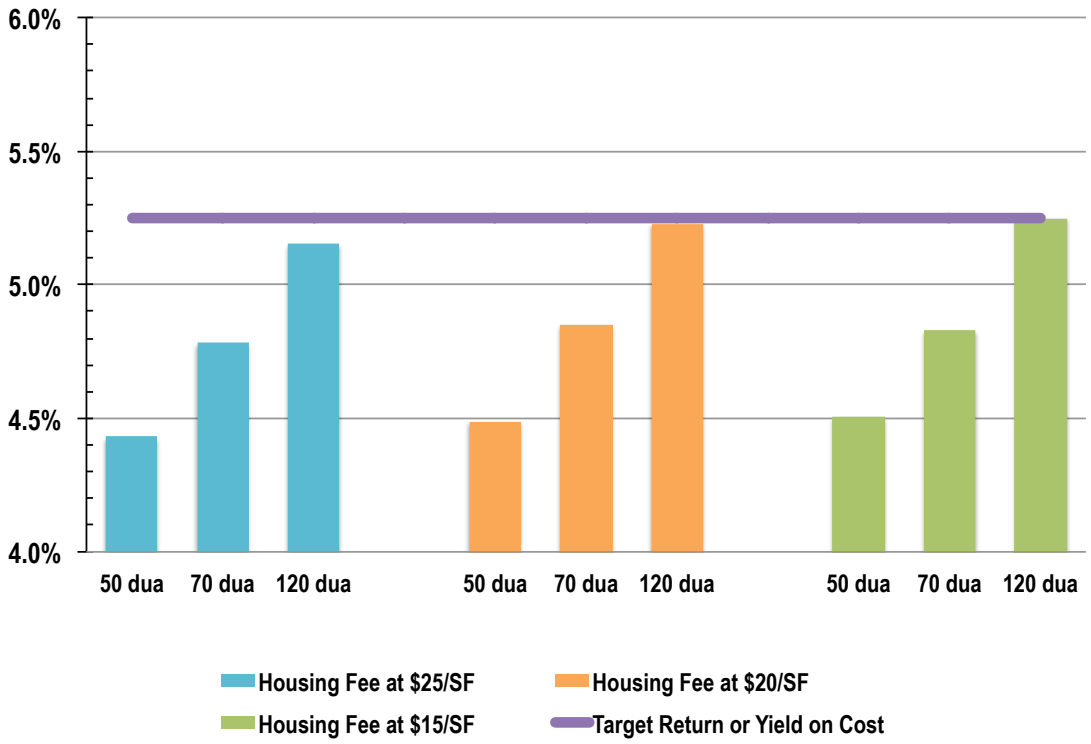
The housing fee is shown as a red bar in Figure D-1, and the light blue bar represents all of the other development costs (except the housing fee). The green bar shows the calculated developer margin or return, which represents the difference between the project value and total development costs.
The feasibility gap is displayed as a checkerboard, which indicates that the development value is not high enough to provide sufficient developer margin/return. Only the apartment development at 120/dua remains financially feasible with these proposed fee levels (does not have a significant feasibility gap).

Figure D-1
Apartment Development Feasibility at Alternative Housing Fee Levels



The financial analysis also analyzes each housing fee scenario using the most common return metric for apartments of YOC (assumed at 5.25%). As shown in Figure D-2, the financial analysis indicates that apartments developed at 120 dua—with lower average land costs per unit—are financially feasible at housing fees of $15/SF and $20/SF while slightly below the feasibility threshold at $25/SF. However, apartment developments at densities of 50 dua and 70 dua not financially feasible under any of the proposed fee levels based on the development cost assumptions assumed for this analysis, which include relatively high land costs per unit.

Figure D-2
Financial Feasibility of Apartments at Alternative Housing Fee Levels



2. Financial Analysis of Condominium and Single Family Attached at Varying Housing Fee Levels

A similar financial analysis was done for the two for-sale housing prototypes: condominium and single family attached.

Figure D-3 shows the effect on development feasibility of three potential housing fee levels on a condominium unit, while Figure D-4 shows the effect on development feasibility on a single family attached unit. As these graphs illustrate, new condominium and single family attached housing is feasible at all of the proposed fee levels of $15/SF, $20/SF and $25/SF.

Figure D-3
Condominium Development Feasibility at Alternative Housing Fee Levels

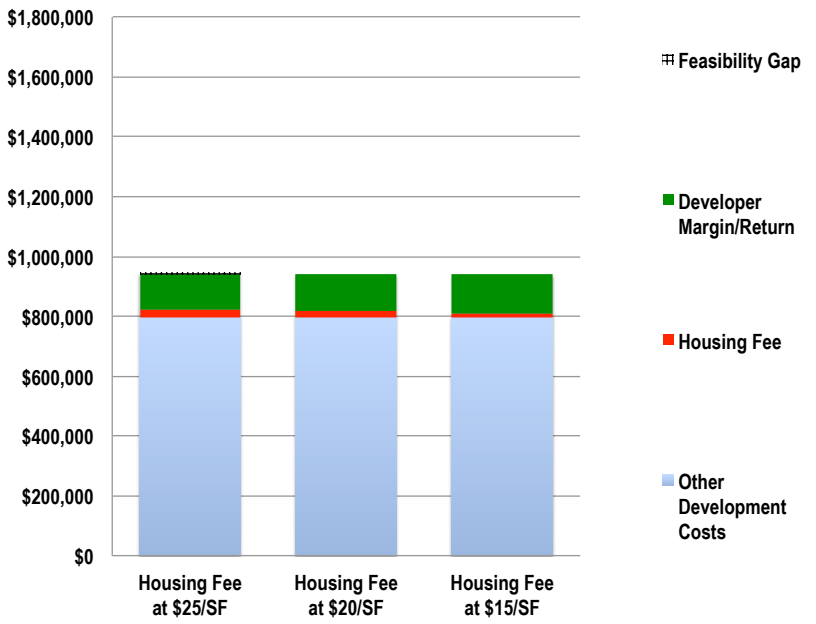
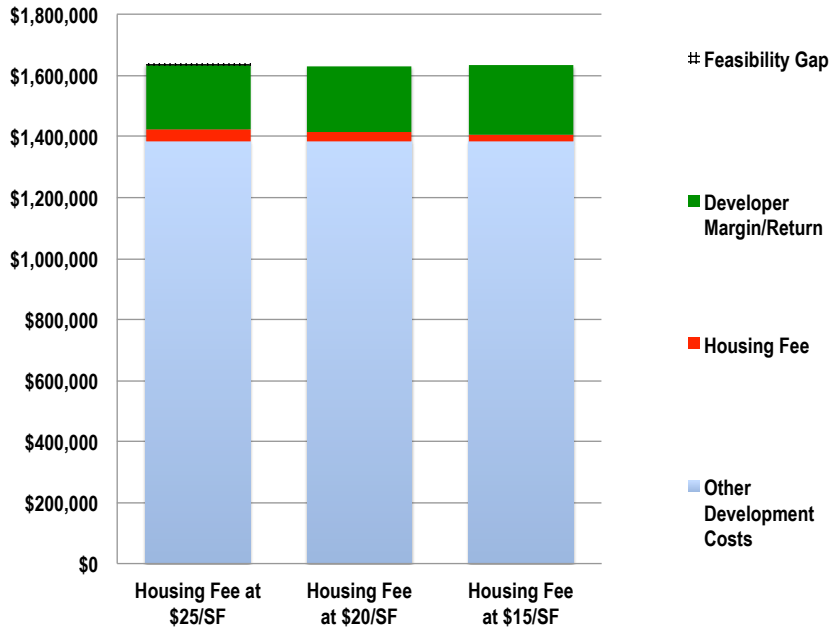


Figure D-4
Single Family Attached Development Feasibility at Alternative Housing Fee Levels



E. Financial Analysis of Onsite Affordable Housing Provision

The next step in the financial analysis is to understand the potential financial trade-offs to a developer from including affordable housing units within new market rate development versus paying a housing fee. As one of the City's key housing goals is to incentivize the onsite provision of affordable housing within new development rather than collect housing fees, this section evaluates the potential financial effects of providing affordable housing onsite to households at various income levels. An affordability gap analysis is used to measure the difference or gap between what households at different income levels can afford to pay for housing and the cost of renting or purchasing housing, which is then factored into project costs.

1. Household Income levels

The California Department of Housing and Community Development (HCD) publishes areawide median income (AMI) levels calculated annually by the US Department of Housing and Urban Development (HUD) for various household income thresholds and different household sizes in San Mateo County:

- Very Low Income (also referred to as VLI) means a household whose income is 50% or below AMI, adjusted for household size.
- Low Income household (also referred to as LI) means a household whose income is above 50% up to 80% AMI. In recent years, HUD has adjusted the LI limits in high-housing cost areas in a way that exceeds these percentages in San Mateo, San Francisco and Marin counties.[8]
- Moderate Income household (also referred to as MOD) means a household whose income is above 80% up to 120% AMI.
- Above Moderate Income (also referred to as Above MOD) means a household whose income is above 120% AMI. This analysis focuses on Above MOD households up to 150% AMI.

Figure E-1 below shows the various household income levels that correspond to different housing types by bedroom size and household size. For example, a one-person, very low income household at or below 50% AMI that occupies a studio (0 Bedroom) unit has a household income threshold of $51,350.

Table E-1
2018 Household Income Levels Corresponding to Housing Types by Bedroom Size
San Mateo County

Hosehold Income Level		Bedroom Size (Persons per Household)				
Income Category	Percent of Areawide Median Income	0 Bedroom (1)	1 Bedroom (2)	2 Bedroom (3)	3 Bedroom (4)	4 Bedroom (5)
Very Low	50%	$51,350	$58,650	$66,000	$73,300	$79,200
Low	60%	$61,650	$70,400	$79,250	$88,000	$95,050
Low	70%	$71,950	$82,200	$92,500	$102,700	$110,950
Low	80%	$82,200	$93,950	$105,700	$117,400	$126,800
Moderate (Median)	100%	$82,900	$94,700	$106,550	$118,400	$127,850
Moderate	110%	$91,200	$104,200	$117,250	$130,250	$140,650
Moderate	120%	$99,450	$113,700	$127,900	$142,100	$153,450
Above Moderate	135%	$111,900	$127,850	$143,850	$159,850	$172,600
Above Moderate	150%	$124,350	$142,050	$159,850	$177,600	$191,800

Source: California Department of Housing and Community Development, HUD

[8] https://www.mercurynews.com/2018/06/25/the-eye-popping-definition-of-what-is-low-income-in-the-bay-area-increases-again/

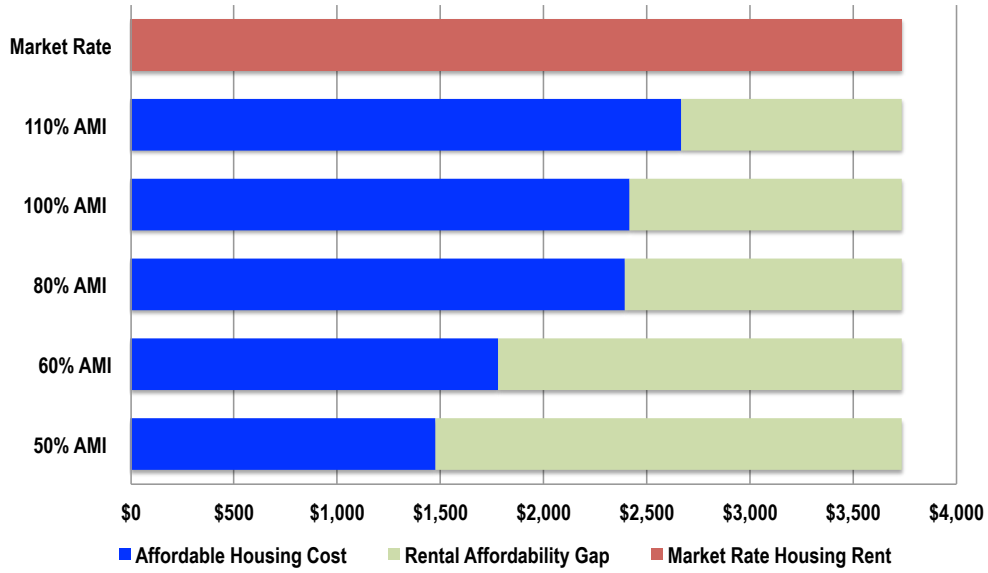
2. Affordability Gap for Apartment Developments

Utilizing the San Mateo County data on household income levels, Seifel analyzed the housing affordability gaps between market rate and below market rate (BMR) apartments that are considered affordable to households at specific AMI levels according to State standards. The analysis was conducted for all of the housing prototypes, but focuses first on the affordability gap for apartments.

Figure E-1 below shows the market rate rent and affordable rent at various target AMI levels for a typical apartment unit, which averages between one to two bedrooms in size based on recent developments.[9] As it illustrates, market rents are about $3,700 for the lower density apartment prototypes while a typical very low income household at 50% AMI (at a typical household size of 2 to 3 persons) can only afford to pay about $1,500 per month in rent (net of a standard utility allowance). This translates to an affordability gap of about $2,200 per month, which is the difference between projected market rents and what a very low income household can afford based on a standard of 30% of income toward housing costs.

Likewise, a moderate income household at 100% AMI can afford to pay about $2,400 per month in rent, resulting in an affordability gap of about $1,300 per month in rent. Households would need to earn about 155% of AMI to be able to afford projected market rents.[10]

Figure E-1
Projected Monthly Rent for Typical New Apartment in Burlingame and Rental Affordability Gap



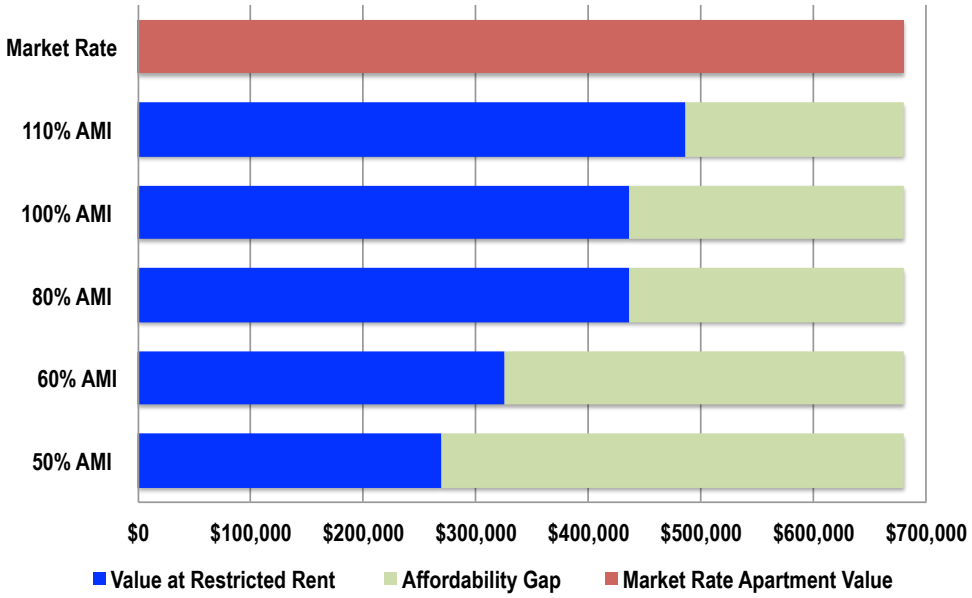
Seifel performed a similar set of calculations to measure the difference or affordability gap between the value of an apartment unit assuming market rate rents and the value assuming BMR rents affordable to households at specific AMI levels. Typical vacancy and operating expense assumptions are used to calculate net operating income (NOI) at alternative rent levels, and the resulting NOI is divided by the

[9] The affordability gap is calculated based on the weighted average distribution of units and corresponding household sizes for both apartment and for-sale prototypes.

[10] The State affordability standard for rental housing is based on 30% of income toward housing for the following household income levels: very low income at 50% AMI, low income at 60% AMI and moderate income at 110% AMI. The affordability standard of 30% of income for rental housing is used for all AMI levels in this analysis.

4.25% cap rate to project values at each target AMI level. Figure E-2 below shows the affordability gap based on apartment values at different household income levels, indicating a difference in value of about $400,000 between the value for a market rate apartment and the value if the apartment were rented at BMR rents affordable to a very low income household.

Figure E-2
Value of a New Apartment in Burlingame and Affordability Gap in Value



Utilizing the San Mateo County data on household income levels, Seifel also analyzed the housing affordability gaps between market rate and below market rate sales prices for condominium and single family attached units that would be affordable at specific AMI levels.

Figure E-3 on the next page shows the market sales price and affordable price at various target AMI levels for a typical condominium unit, which averages about two bedrooms in size based on recent developments. As it illustrates, market prices for new condominiums are projected to be about $939,000 while a moderate income household at 100% AMI (at a typical household size of about 3 persons) can only afford to pay about $360,000, which translates to an affordability gap of about $580,000, which is the difference between projected market sales price and what a moderate income household at 100% AMI can afford based on a standard of 30% of income toward housing costs.[11]

Figure E-4 on the next page likewise shows the market sales price and affordable price at various target AMI levels for a typical single family attached unit, which also averages about two bedrooms in size based on recent developments. As it illustrates, market prices for new single family attached units are projected to be about $1.63 million while a moderate income household at 100% AMI (at a typical household size of about 3 persons) can only afford to pay about $360,000, which translates to an affordability gap of about $1.27 million.[12]

[11] The State affordability standard for ownership housing for a moderate income household is based on 35% of income toward housing for households at 110% AMI, and this 35% of income standard is applied to all AMI levels at 110% AMI and above for ownership housing. The 30% of income standard is applied to all AMI levels below 110% AMI for ownership housing in this analysis.

[12] Ibid.

Figure E-3
Affordability Gap for Condominium Unit in Burlingame at Various AMI Levels

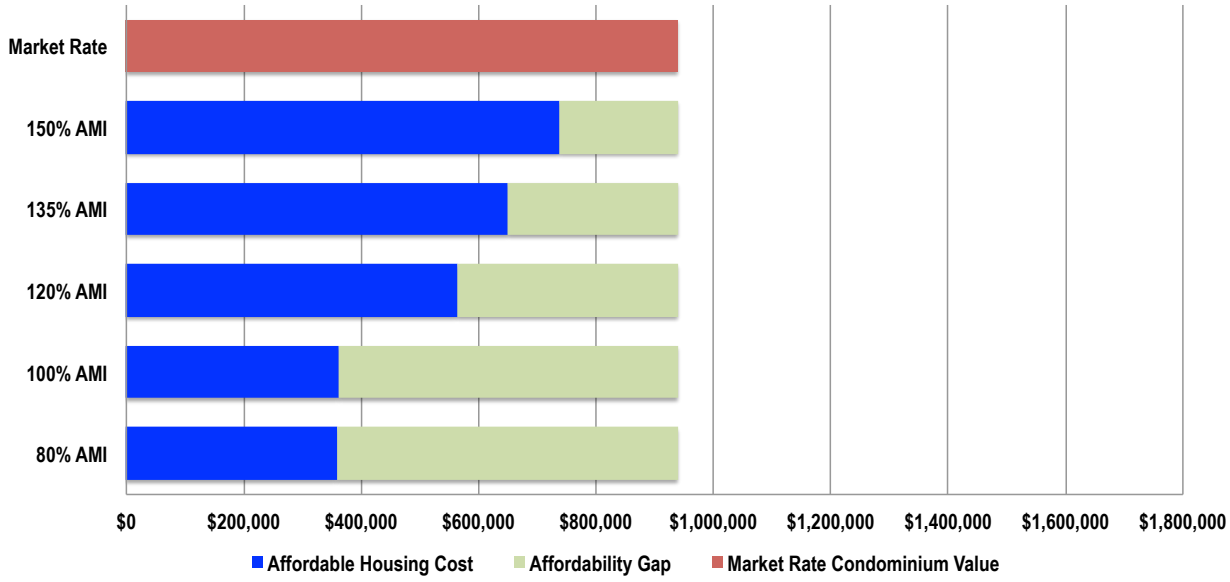
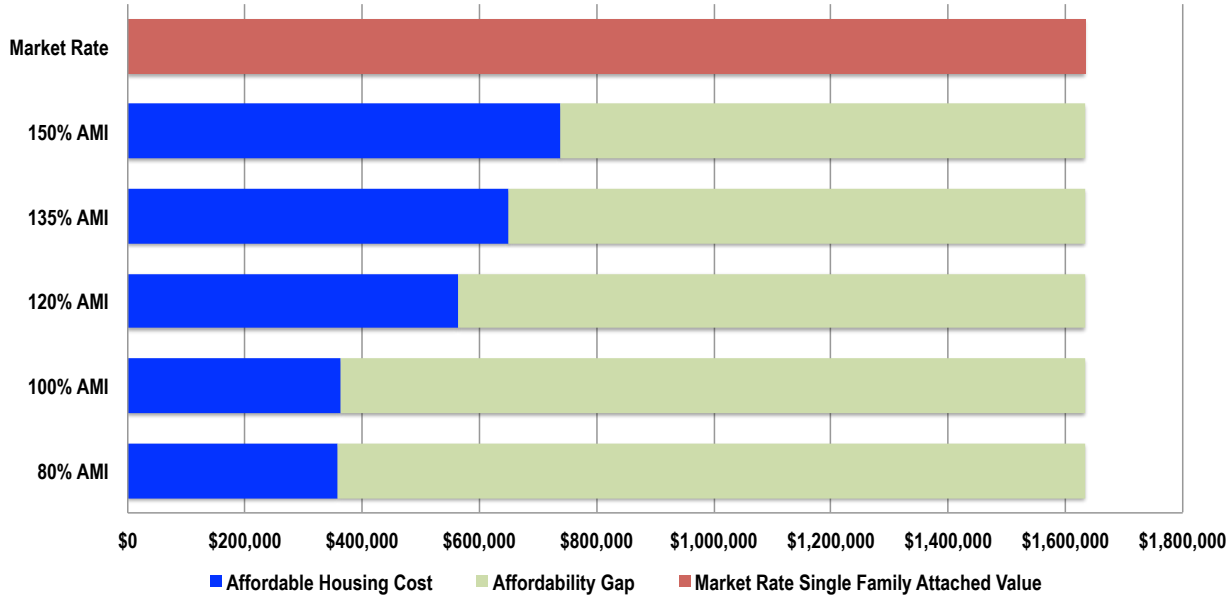


Figure E-4
Affordability Gap for Single Family Attached Unit in Burlingame at Various AMI Levels



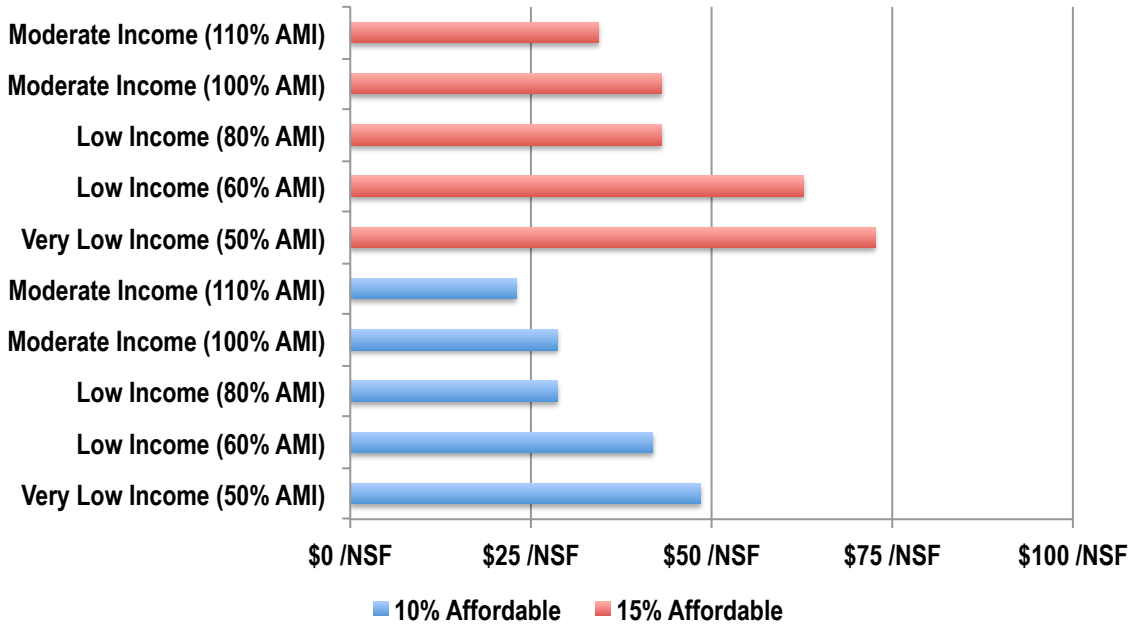
3. Financial Effect of Alternative Onsite Apartment Requirements

Based on discussions with City staff, Seifel evaluated the financial effect of alternative affordable housing policy options on development feasibility for apartments by comparing how much it would cost to provide varying percentages of affordable housing units at different target household AMI levels. Given the significant affordability gaps for apartments, Seifel performed sensitivity analysis related to the following onsite affordable housing compliance options for apartments:

- Percentage of affordable units to be provided onsite– 10% and 15%
- Target household income levels– Very low income (50% AMI), low income (60% and 80% AMI) and moderate income (100% and 110% AMI)

As one of the key City policy objectives is to incentivize the provision of onsite affordable housing instead of the payment of housing fees, this analysis calculates the potential cost to the developer of providing housing onsite on a per residential net square foot basis for a typical apartment. For example, one scenario analyzed the potential cost to a developer of providing a mixed income apartment development with 15% of units rented at BMR rents that are affordable to very low income households at 50% AMI, which translates to a cost of about $75/NSF in contrast to a cost of about $45/NSF for moderate income households at 100% AMI. Figure E-5 illustrates the potential financial effect of providing affordable apartments at alternative onsite requirements within these compliance options.

Figure E-5
Affordability Gap at Alternative Onsite Affordable Housing Requirements on Apartments



4. Financial Effect of Alternative Onsite Ownership Requirements

Figure E-6 similarly illustrates the potential financial effect of providing onsite affordable housing within condominium developments given alternative onsite requirements. Given the significant affordability gaps for both of the for-sale housing prototypes, Seifel performed sensitivity analysis on the following onsite affordable housing compliance options for condominiums and single family attached units:

- Percentage of affordable units to be provided onsite– 10% and 15%
- Target household income levels–Low income (80% AMI), moderate income (100% and 120% AMI) and above moderate income (135% and 150% AMI)

As an example, one scenario analyzed the potential cost to a developer of providing a mixed income condo development with 15% of units sold at prices that are affordable to moderate income households at 100% AMI, which translates to a cost of about $85/NSF in contrast to a cost of about $30/NSF for units priced to be affordable at 150% AMI, which is closest to the proposed housing fee level of $25/NSF.

Figure E-6
Affordability Gap at Alternative Onsite Affordable Housing Requirements on Condominium Units

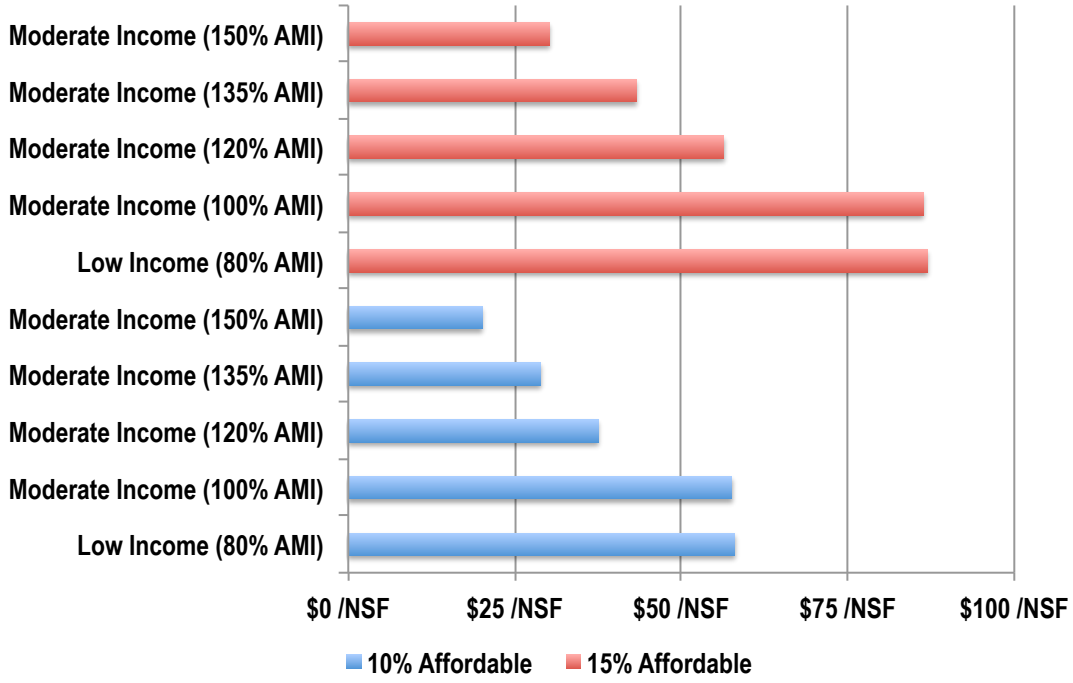


Figure E-7a similarly illustrates the potential financial effect of providing onsite affordable housing within single family attached developments given alternative onsite requirements. Given the significant affordability gaps for single family attached units, an alternative scenario was tested that assumed smaller onsite affordable units (1,200 NSF versus the typical average size of 1,500 NSF), which substantially lowered the potential cost to a developer of providing a mixed income single family development.
As shown in Figure E-7b, even when smaller units are assumed, the cost of providing 15% of units at prices that are affordable to moderate income households at 100% AMI translated to a cost of about $130/NSF while the cost of providing units to above moderate income households at 150% AMI was about $90/NSF.

Figure E-7a
Affordability Gap at Alternative Onsite Affordable Housing Requirements on Single Family Attached Units (1,500 NSF/Unit)

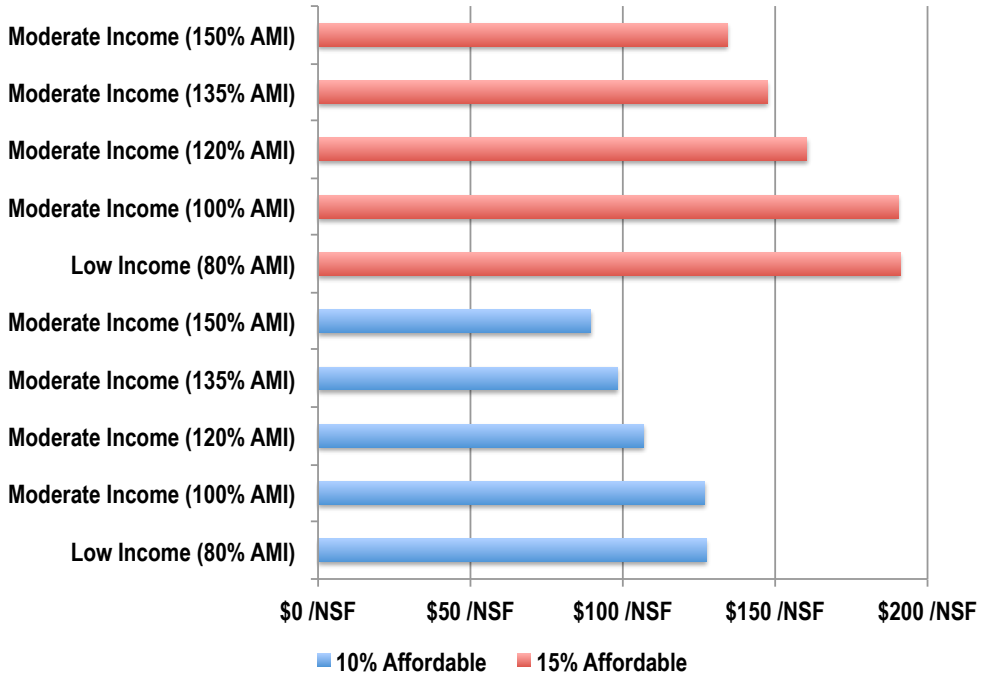
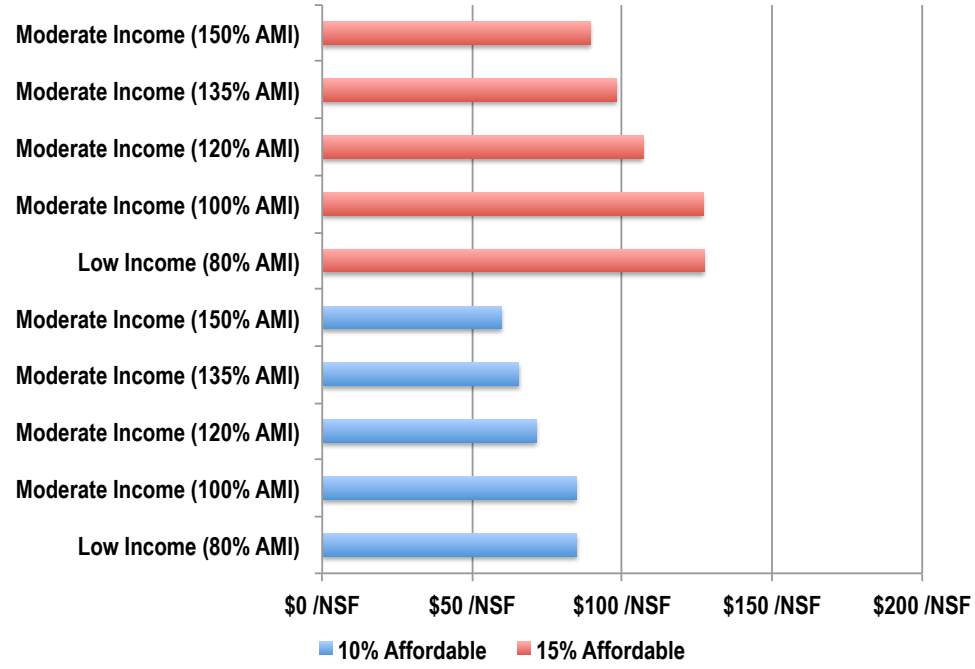


Figure E-7b
Affordability Gap at Alternative Onsite Affordable Housing Requirements on Smaller Single Family Attached Units (1,200 NSF/Unit)



F. Financial Feasibility of Onsite Affordable Housing Provision

The next step in the financial analysis is to understand how the inclusion of affordable housing units within new market rate development will likely affect development feasibility of housing in Burlingame, as one of the City's key housing goals is to incentivize the onsite provision of affordable housing within new development rather than through the payment of housing fees. Given the significant cost of providing affordable units onsite, this section focuses on testing onsite requirements at 10% of total housing units.

Apartment prototypes are tested based on three potential onsite housing compliance scenarios:

- Scenario 1– 10% of units at 100% AMI
- Scenario 2– 10% at 110% AMI
- Scenario 3– 5% at 80% AMI and 5% at 110% AMI

Ownership prototypes are tested based on three alternative onsite housing compliance scenarios:

- Scenario 1– 10% at 110% AMI
- Scenario 2– 7% of units at 110% AMI and 3% at 135% AMI
- Scenario 3– 5% of units at 110% AMI and 5% at 135% AMI

1. Feasibility of Alternative Onsite Apartment Requirements

As Figure F-1a indicates, development feasibility is improved by allowing developers to provide units onsite that are affordable to moderate income households and by requiring an onsite housing requirement of 10% instead of 15% as additional rental income would be generated. However, only the highest density scenario at 120 dua is feasible under any of the scenarios that are tested.

Figure F-1a
Apartment Development Feasibility Under Alternative Onsite Affordable Housing Requirements

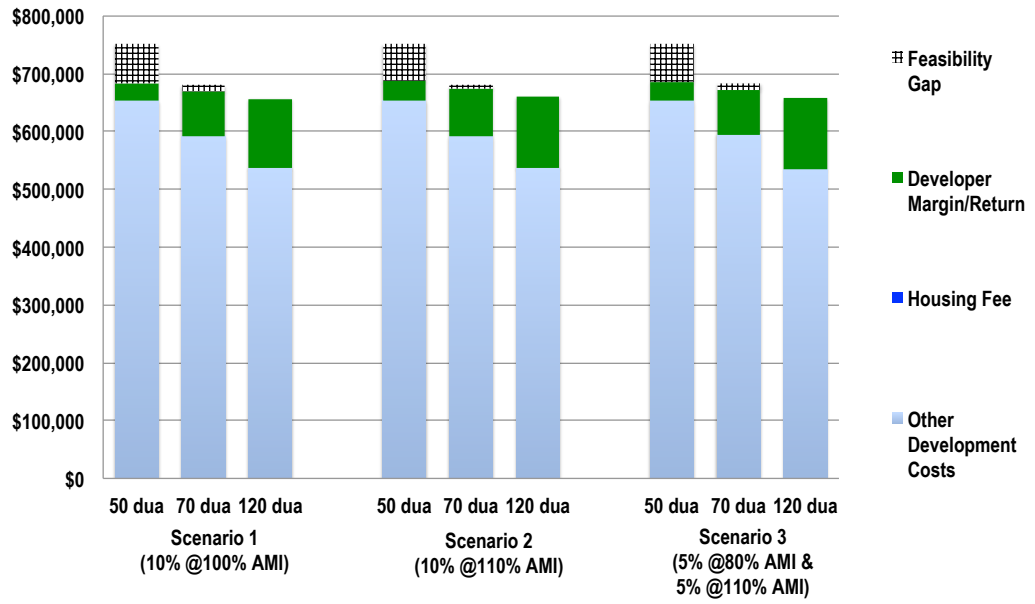
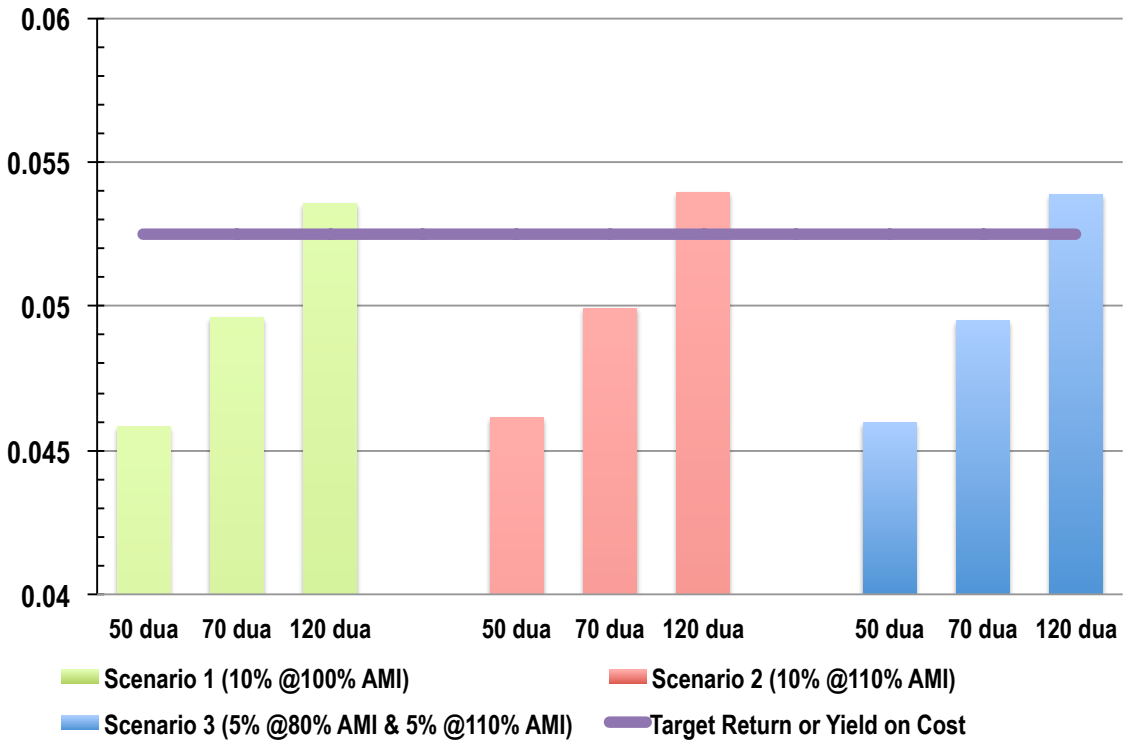


Figure F-1b shows development feasibility based on the most common return metric for apartments of YOC (assumed at 5.25%). The feasibility analysis indicates that apartments developed at 120 du/acre are financially feasible under all affordability scenarios, as shown in Figure E-7. However, apartment developments at densities of 50 du/acre and 70 du/acre are not financially feasible under any of the affordability scenarios based on the development cost assumptions assumed for this analysis.

Figure F-1b
Apartment Feasibility Based on YOC Under Alternative Onsite Affordable Housing Requirements



2. Feasibility of Alternative Onsite Ownership Requirements

Figures F-2 and F-3 similarly illustrate how development feasibility improves by allowing developers to provide units onsite that are affordable to moderate income and above moderate income households at 135% AMI. As these figures illustrate, condominium developments will likely be feasible with a 10% onsite affordable housing requirement that is focused on moderate income households with an option to provide housing that is affordable to above moderate income households under a high development cost scenario. In contrast, single family attached housing does have a feasibility gap under the three potential onsite housing scenarios, but this gap would be significantly reduced if affordable housing units could be provided at smaller unit sizes, such as 1,200 square feet as tested earlier.

Figure F-2
Condominium Feasibility Under Alternative Onsite Housing Requirements

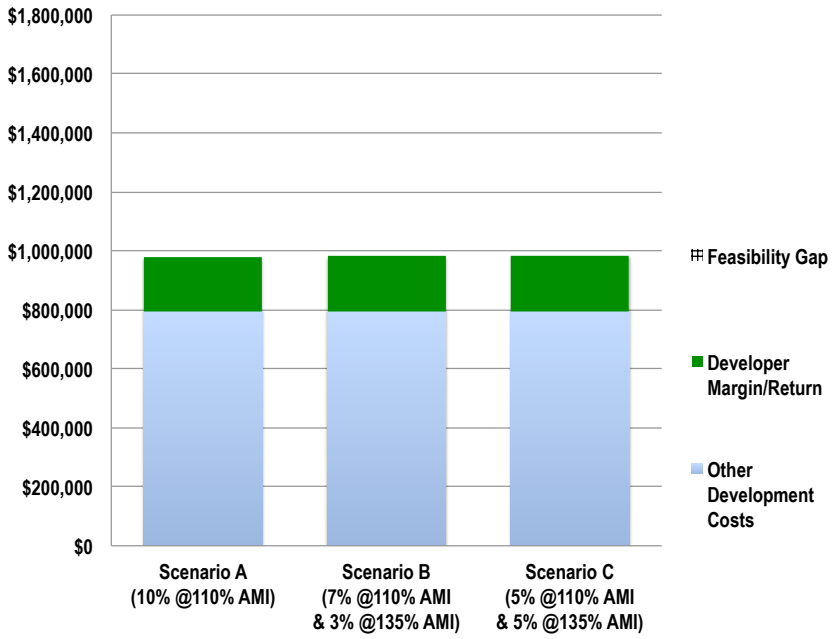
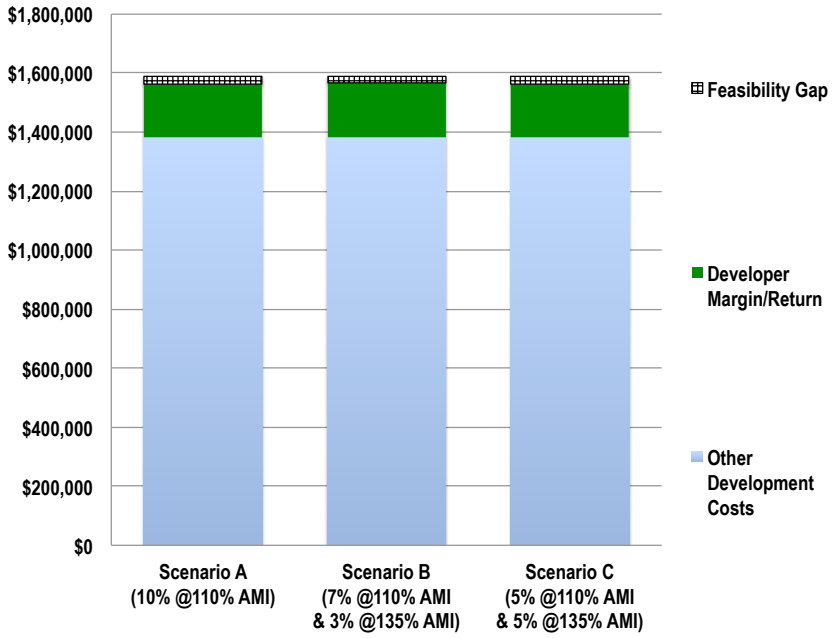


Figure F-3
Single Family Attached Feasibility Under Alternative Onsite Housing Requirements



G. Conclusion

As development costs have increased over the past few years, developers are finding it increasingly difficult to develop new housing in the City of Burlingame, and the City must carefully consider how best to implement its affordable housing programs in order to continually encourage new residential development to occur.

As rents and prices have continued to increase, the difference between the cost of housing and what many households can afford to pay for housing has increased, leading to a widening "affordability gap" for new housing. In order for new development to be financially feasible when including onsite affordable housing units, the cost of providing new affordable housing must be able to be factored into the total costs of developing housing while still leaving sufficient developer margin or return to allow development to go forward. Given the complexities of finding qualified households and assuring continued affordability of onsite affordable housing units, developers typically prefer to pay a housing fee rather than build housing units onsite unless the cost of providing units onsite is less than paying the fee.

1. Key Findings from Apartment Analysis

- Apartment rents are not increasing as fast as construction costs, making it more difficult for apartments to be financially feasible.
- Depending on total development costs associated with new apartments, rental units may not yield sufficient returns to attract capital (creating a development feasibility gap).
- Higher density apartment developments are more financially feasible when land values can be spread among a greater number of units, providing greater opportunities for developers to pay for public requirements such as affordable housing.
- The financial analysis indicates that housing fees at higher fee levels (between $20–$25/SF) should be focused on higher density rental developments of 100 dwelling units per acre or more.
- Onsite affordable housing requirements of 10% of total units focused on moderate income households (between 80% and 120% AMI) are more financially feasible and best correlate to housing fee levels between $15 and $25/SF.

2. Key Findings from Analysis of Condominium and Single Family Attached Units

- Housing prices have been increasing rapidly, and most buyers need significant cash or "trade-up" value in homes to afford new units, making it much more difficult for first-time homebuyers to purchase a new home.
- For-sale developments are more financially feasible than apartments given high price points, but the housing affordability gap is much greater, particularly for large units.
- The financial analysis indicates that housing fees at $25/SF can be supported by new ownership development in Burlingame.
- Allowing affordable housing units to be a smaller size, particularly for single family attached units, enhances financial feasibility and thus encourages the provision of housing onsite.
- Onsite affordable housing requirements of 10% of total units focused on households between 110% and 135% AMI are financially feasible for ownership housing assuming reasonable development costs.

3. Policy Considerations to Encourage Onsite Affordable Housing

Based on the financial analysis shown in this report, input from real estate professionals active in San Mateo County and best practices from other cities, the City may want to consider the following policies to encourage the provision of onsite affordable housing in Burlingame, as these policies will enhance financial feasibility for new housing development:

- Develop a more predictable and streamlined process for land use approval and design review in order to reduce the time and risk associated with infill development.
- Allow more housing units to be built, along with incentives and concessions similar to what is allowed under State Density Bonus Law, when developers provide onsite affordable housing.
- Allow smaller sized units to be dedicated as affordable housing (especially for ownership, single family attached units) so long as they meet the minimum size standards of the California Tax Credit Allocation Committee and are not below a certain threshold requirement established by the City (such as cannot be smaller than 70% to 75% of the average square footage for a similar unit type).[13]
- While the bedroom mix of the affordable units should be proportionate to the bedroom mix of market rate units, potentially allow a different unit mix if it furthers other City goals.
- Encourage the dispersion of affordable housing units throughout new development but allow developments with higher heights to evenly distribute units throughout the first five floors (or 60% of all floors), which will allow upper floors to be rented or sold at higher prices.
- Allow reductions in citywide parking standards for residential and retail (with respect to parking stall size and parking ratios), especially near transit and public parking.
- Limit the total cost of City imposed permit, processing and development impact fees to levels that are close to current levels and provide developers with certainty regarding how much these fees will increase annually until building permits are pulled. (For example, link future increases in fee amounts after initial development application to published inflationary indices.)

In conclusion, this analysis indicates that the City of Burlingame can achieve its housing goal to encourage the onsite provision of housing to address the City's affordable housing needs by carefully crafting its housing fee program to incentivize the provision of housing onsite through the establishment of varying fee levels for apartment and ownership housing, and by implementing some or all of the housing policy options discussed above.

[13] As of July 2018, the minimum unit sizes for the California Tax Credit Allocation Committee are: 450 square feet for a one-bedroom, 700 square feet for a two-bedroom and 900 square feet for a three-bedroom unit, although access requirements for persons with disabilities may lead to slightly larger unit size requirements.