KEYSER MARSTON ASSOCIATES™
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Rebecca Garcia, Housing Manager
City of Morgan Hill

From: Debbie Kern

Date: March 28, 2018

Subject: Strategy for Increasing the Supply of Affordable Housing

In accordance with your request, Keyser Marston Associates, Inc. (KMA) has identified potential programs to increase the supply of affordable housing. This is an initial list for the City's consideration.

Background

The following chart summarizes the City's RHNA allocation goals and anticipated status through 2022. As shown, it is anticipated that the City will have met its RHNA goals in the Above Moderate and Low Income categories. However, significant deficits are projected for the Very Low and Moderate Income categories, at 233 and 169 units, respectively. Given these projections, the City is exploring programs that it could pursue to increase the production of affordable housing in the City and requested KMA to identify potential options.

Current 2015 – 2022 Regional Housing Needs Allocation (RHNA) Goals

Income Level	RHNA unit Goal	Permits Issued to date *(not including 2018)*	% of RHNA Met	Units + or -
Very Low (0-50% AMI) *includes 30% AMI for reporting purposes*	273	40	14.65%	-233
Low (50-80% AMI)	154	158	102.60%	+4
Moderate (80-120% AMI)	185	16	8.65%	-169
Above Moderate (120% +AMI)	316	896	283.54%	+580
TOTAL RHNA	**928**	**1,110**	**119.61%**	**+182**

Potential Programs

1. Encouraging Accessory Dwelling Units "ADUs" (Secondary Units)

Many cities are adopting provisions to encourage the development of Accessory Dwelling Units (ADUs). ADUs can count toward RHNA goals, even without deed restrictions provided that the City provides a survey of comparable units demonstrating that ADU rents are affordable to very-low income, low-income and moderate income households. ADUs can be built as free standing units, expansions to existing homes, or the conversion of existing space within a home.

The City of Santa Cruz has adopted a program to encourage the development of ADUs, which has proven to be very successful. In summary, Santa Cruz's program consists of four components:

- *Zoning incentives* – eliminated covered parking requirements and allowed parking in the front yard setback.

- *"How To" Manual and Design Prototypes* – City prepared a step by step manual to help homeowners through the design, application and construction process. And, the city engaged seven architects to create a range of ADU prototypes, which were then pre-approved by the City's Planning Department.

- *Financing* – City offers an ADU loan program and a fee waiver program if units will be subject to long term deed restrictions,

- *Community education* – City held five community workshops to inform residents about the program.

Other cities are adopting standards for ADUs, which help homeowners understand the applicable requirements.

Potential strategies for Morgan Hill could include:

a. Surveying rental rates for studios to determine if market rate rents are naturally consistent with Very Low, Low or Moderate income rents for single person households;

b. Increasing RDCS points for providing more ADUs. For example, the RDCs currently awards 3 points if more than 30% of the units have ADUs. To incentivize the development of ADUs, the RDCS could provide 1 point for every 8% of units with ADUs. If 80% of the units had ADUs, the project would receive 10 points.

c. Reducing / waiving fees and providing incentives for ADUs;

d. Applying for SB 2 funds from the State to provide financing for ADUs;

e. Preparing a comprehensive program, similar to the Santa Cruz program (SB 2 funds could potentially be a funding source for preparing a program);

f. Establishing and publishing requirements for ADUs;

2. Modifying the RDCS Point Structure

a. Provide *Points for Moderate Income units in Market Rate Rental Projects* – The current point structure only provides points for the inclusion of Extremely Low, Very Low and Low income rental units. A "moderate income" category could be added, with projects receiving points for the inclusion of moderate income units affordable, at say, 100% of AMI.

b. For Sale Market Rate Projects – Increase the inclusionary percentage from 8% to 10% or 12% and eliminate the on-site requirement for 70% AMI units. While increasing the on-site requirement to 10% or 12% will reduce sales proceeds to developers, the impact can be mitigated by eliminating the requirement to provide 70% AMI units and increasing the requirement for Moderate units. For example, the requirements could be as follows:

70% AMI	90% AMI	110% AMI	Points
0%	2%	8%	30
		10%	28
		12%	32

c. For Sale Affordable Projects – Eliminate the 70% and 80% AMI Categories. The program currently incentivizes providing units at 70% AMI and 80% AMI. To increase the supply of Moderate income units, the City could eliminate the Low income categories.

d. Rental Affordable Projects – Reduce Percentages for Low Income Units. In order to create more Very Low Income units, the City could increase the percentage requirements for Very Low Income Units and decrease the percentage requirements for Low Income Units.

e. Increasing RDCS points for ADU Units – As noted above, the RDCs currently awards 3 points if more than 30% of the units have ADUs. To incentivize the development of ADUs, the RDCS could provide 1 point for every 8% of units with ADUs. If 80% of the units had ADUs, the project would receive 10 points.

f. *Increasing the RDCS Inclusionary Requirement to 15%* – The RDCS program currently provides points for projects that provide up to 10% inclusionary units. This percentage is, in part, driven by the balance of the point system and benefits that must be provided in order to be competitive in the RDCS competition. If the City increases the affordable housing points system so that 15% inclusionary yields the same points as 10% inclusionary currently does, developers will likely try to secure points in other categories because the "cost" of the affordable housing points will have increased. To neutralize this incentive, the City could modify the point system for all categories to maintain the relative cost of different categories. Or, if the City wants to prioritize affordable housing over the other point system categories, the RDCS could be modified to increase the points for providing 15% inclusionary units and reducing the points for other categories. Under either approach, development costs would increase and the number of points of successful projects would likely decrease and community benefits would decrease. To mitigate this impact, the City could seek to identify incentives that would reduce building costs or increase value, such as reducing setback requirements or parking requirements.

3. Sponsor Public/Private Partnerships for Affordable Housing

a. *Development of Surplus City-owned property*. The City could identify a city-owned property that could be developed with affordable housing and issue an RFP for development proposals. The City's participation could be in the form of leasing the site to the development, or selling at a reduced price to enable the private sector to build affordable housing. An ownership project could be targeted to Moderate Income households or a rental project could be targeted toward Very Low income households.

b. *Leveraging Affordable Housing Fee Revenues for New Development.* The City could use housing fee revenues to assist private developers build affordable units. The City could give priority to projects that leverage other funds, such as LIHTC revenue or State funding for Veterans housing.

c. *Dedicating Redevelopment Property Tax Trust Fund (RPTTF) revenues to the development of Affordable Housing.* If available, the City could dedicate a portion of its former Redevelopment funds to the development of affordable housing and use the funds to leverage other funding sources secured by private developers.

4. Modifying the RDCS Program to Permit the Development of Target Affordable Units to Not Count Against the Annual Building Permit Cap

While the RDCS has been an effective tool for increasing the City's supply of affordable housing, it has not provided a sufficient incentive to meet the City's RHNA production goals. Meeting the goals for Very Low and Moderate Income units will be a serious challenge to the City. One option to consider would be to amend the RDCS program to exclude affordable units from the annual cap on the number of residential building permits. The feasibility of this strategy would require review by the City's legal counsel.

5. Provide cost saving incentives for Projects that Provide Excess Target Affordable Units

The City could study options for reducing the cost of developing Very Low and Moderate Income units. For example, the City could reduce zoning requirements, such as parking requirements or reduce impact fees on projects that provide affordable housing units beyond the percentages provided in the RDCS points system.