

Memorandum

To: City Council

From: Andy Agle, Director of Housing and Economic Development



Re: **Proposed FY 2019-20 Annual Adjustment for the Affordable Housing Unit Development Cost**

This memo summarizes the results of applying an annual adjustment to the Affordable Housing Unit Development Cost pursuant to Santa Monica Municipal Code (SMMC) Section 9.64.070.C (“ . . . Commencing on July 1, 2007 and on July 1st of each fiscal year thereafter, the City’s affordable housing unit development cost shall be adjusted based on changes in construction costs and land costs . . .”). The inflation methodology is the same as that used to produce annual adjustments for the Affordable Housing Unit Base Fee, pursuant to SMMC Section 9.64.070.B. That methodology was approved by the Santa Monica City Council at a public hearing on June 13, 2006, based on the recommendation of HR&A in a letter to City staff dated April 24, 2006. A copy of the April 24, 2006 letter is included for reference as Attachment A hereto.

SMMC Section 9.64.070.A.2 provides that developers of market rate multi-family housing are eligible to pay a fee equal to a fraction of an affordable unit when the number of units otherwise required by Section 9.64.050.D is less than 0.75. In such cases, the amount of the fee is equal to the City’s Affordable Housing Unit Development Cost multiplied by the fractional unit. The City’s Affordable Housing Development Unit Cost is defined as the average cost to the City to develop a unit of housing affordable to low- and moderate-income households. The Affordable Housing Unit Development Cost was originally estimated to be \$239,949, as contained in the nexus study prepared by HR&A in 2005¹ to support the imposition of the Affordable Housing Unit Base Fee. The amount of the Affordable Housing Unit Development Cost is equal to the City’s total cost to develop a unit of affordable housing (i.e., land, construction, professional fees and other “soft” costs and financing costs) minus the amount of construction loan that can be supported by the net operating income derived from operating a typical City-assisted affordable housing development. A 2005-2007 cumulative inflation increase for the Affordable Housing Unit Development Cost to \$265,632 using the approved methodology was adopted by the City Council when it approved Resolution No. 10230 (CCS) on July 24, 2007. The City Council approved the last annual increase for FY 2018-19 using this methodology when it adopted Resolution No. 11131 (CCS) on August 14, 2018.

¹ Hamilton, Rabinovitz & Alschuler, Inc., *The Nexus Between New Market Rate Multi-Family Developments in the City of Santa Monica and the Need for Affordable Housing, 2005 Update*, July 1, 2005, prepared for the City of Santa Monica.

For the construction cost inflation component of the calculation approach, the Engineering News Record's (ENR) Construction Cost Index specific to the Los Angeles metro area is utilized, because it is updated monthly and is readily available via the Internet with a subscription. The applicable index change was 0.1 percent measured between March 2019 (the current budget adoption year) and March 2018, as compared with a 3.3 percent change between March 2018 and March 2017.

Although there is no comparable index for inflation in land cost, the City-adopted calculation method uses the weighted average annual change in median condominium sale prices, by ZIP Code, as a proxy measure for land cost changes measured for the immediately preceding calendar year. Based on our analysis of 2018 sales data compiled by Dataquick from Los Angeles County Assessor records, the weighted average change for the City during 2018 was 8.6 percent, as compared with a 9.8 percent increase during 2017.

The relative balance between land cost inflation (based on changes in median condo prices) and construction cost inflation (based on a construction cost index) continues to be based on development cost data for the two most recently completed and/or under-construction multi-family affordable developments assisted by the City. For the current analysis, the two City-assisted projects are 2802 Pico Boulevard and 430 Pico Boulevard. The City-adopted calculation approach uses a simple average of the ratio between land purchase price and the sum of land cost and hard construction cost to derive the land value percentage (25.3%). The inverse of the land value percentage is the construction cost share (74.7%).

Table 1, on the following page, presents the annual adjustment calculation establishing the Affordable Housing Unit Development Cost for FY 2019-20. It shows that a weighted average inflation index using the City Council-approved approach results in a 2.2 percent annual increase (compared with a 5.0 percent increase for FY 2018-19), to \$382,795, which is a \$8,240 increase compared with the FY 2018-19 Housing Unit Cost.

The results of the calculations shown in Table 1 will be the basis for a Resolution changing the Affordable Housing Unit Development Cost for FY 2019-20.

Table 1
Affordable Housing Development Cost Annual Inflation Adjustment Calculations for FY 2019-2020

Land Cost Inflation

Zip Code	Median Price Change		# Condos Sold	Calculation	
	2017-2018			Weights	Weighted Avg.
90401	25.4%		16	3.8%	1.0%
90402	-1.4%		32	7.6%	-0.1%
90403	7.4%		176	41.7%	3.1%
90404	7.5%		99	23.5%	1.8%
90405	11.9%		99	23.5%	2.8%
			422	100.1%	8.6%

Source: CoreLogic Information Services (subscription required; data available from Housing Division, City of Santa Monica)

Construction Cost Inflation

Engineering News Record's Construction Cost Index -- Los Angeles

March 2018 Index Value	11935.82
March 2019 Index Value	11943.60
Percentage Change 2018-2019	0.1%

Source: Engineering News Record (subscription required; data available from Housing Division, City of Santa Monica)

Derivation of Land Cost and Construction Cost Calculation Weights

Most Recent CCSM Family Rental Projects	Hard Construction		Sum
	Land Cost	Cost	
2802 Pico	\$ 3,625,000	\$ 12,630,138	\$ 16,255,138
430 Pico	\$ 4,500,000	\$ 11,361,066	\$ 15,861,066
	\$ 8,125,000	\$ 23,991,204	\$ 32,116,204
	25.3%	74.7%	100.0%

Source: Housing Division, City of Santa Monica

Inflation Factor Derivation

	Inflation Value	Weight	Wtd. Avg.
Land Value Inflation	8.6%	25.3%	2.2%
Construction Cost Inflation	0.1%	74.7%	0.0%
			2.2%

Adjusted Unit Cost

	FY 2018-19 Cost/Unit	Inflation Factor	Updated Cost/Unit	\$ Change
Affordable Housing Development Cost	\$ 374,555	2.2%	\$ 382,795	\$ 8,240

For Information Only:

Consumer Price Index Change, LA-Riv-Or Co., All Urban Consumers, 1982-84 = 100	
Mar. 2018 Index Value	264.158
Mar. 2019 Index Value	271.311
Percentage Change Mar. 2018-Mar. 2019	2.7%
Source: US Bureau of Labor Statistics (available at http://www.bls.gov/cpi)	

ATTACHMENT A

**April 24, 2006 HR&A Letter re: Annual Adjustment
Methodology**



HAMILTON, RABINOVITZ & ALSCHULER, INC.
Policy, Financial & Management Consultants

April 24, 2006

Mr. Ron Barefield
Housing Administrator
City of Santa Monica
2121 Cloverfield Blvd., Suite 100
Santa Monica, CA 90405

Re: Annual Adjustment for the Affordable Housing Fee

Dear Ron:

Per your request, this letter summarizes an annual adjustment approach we recommended for the City of Santa Monica's ("City") Affordable Housing Fee, which developers of multi-family residential developers may elect to pay, pursuant to Santa Monica Municipal Code Section 9.56.070, as amended. This recommendation was included in Section V of our recent report, *2005 Update, The Nexus Between New Market Rate Multi-Family Developments in the City of Santa Monica and the Need for Affordable Housing*, July 1, 2005 ("2005 Nexus Study Update").

In order to better ensure that the Affordable Housing Fees remain consistent with changing market conditions, it would be prudent for the City to apply an annual adjustment index, but to use an inflation concept other than the Consumer Price Index (CPI). While the CPI is often used to make inflation adjustments because of its convenience, the monthly changes in the value of consumer goods that dominate the CPI are not the most appropriate basis for measuring change in the City's cost to develop affordable housing. However, to be meaningful, any alternative index must rely on data that is readily accessible to City staff for calculating the change, and for the public's information.

A suitable alternative approach would need to measure annual changes in land cost and construction costs, which together account for about 75-80 percent of the cost of new affordable housing development.¹ There are, in our experience, several well-established construction cost indices. We recommend Engineering News Record's (ENR) Construction Cost Index, because it

¹ The other 20-25% consists of professional fees and other "soft costs" and financing costs, neither of which is regularly monitored by third party sources for inflation changes.

Ron Barefield
Housing Division
City of Santa Monica
April 24, 2006

is updated monthly and is readily available via the Internet. However, there is no comparable index of changes in land cost. One proxy measure that could be used for land cost changes is change in median condominium purchase prices.² Since the median condo sale price for the City as a whole would be skewed by the tendency for sales to be concentrated in a few subareas, a more neutral measure would be the weighted average annual change in median condo sale prices by ZIP Code. These data are published by the Los Angeles *Times* each January, using Los Angeles County Assessor data compiled by Dataquick. They are also available on a subscription basis from other vendors, such as First American Real Estate Solutions.

The relative balance between land cost inflation (based on changes in median condo prices) and construction cost inflation (based on a construction cost index) could be determined based on current development cost data for recently completed or construction-in-progress multi-family affordable developments assisted by the City. We recommend using a simple average of the ratio between land purchase price and the sum of land cost and hard construction cost to derive the land value percentage; the inverse of this ratio would be the construction cost share.³

Since the proposed annual inflation adjustments to the Affordable Housing Fee will be adopted by Resolution of the City Council as part of the annual budget process each June, we recommend that City staff measure the weighted average annual change in median condominium price for the immediately preceding calendar year, and the construction cost index change between March of the budget adoption year and March of the immediately preceding year. We recommend using the annual change in median condo prices in the calculation, rather than year-over-year changes in March or any other month, because median monthly prices can vary significantly due to the number of sales and particular composition of the sales in any particular month. The annual average tends to smooth out these effects. We recommend the monthly year-over-year approach for construction costs, however, because construction represents a much larger share of total project cost. Using the most recently available construction cost inflation data better ensures that the Affordable Housing Fee will keep pace with the actual cost to the City of developing affordable housing.

Table 1 below, which is a variation on Table V-5 from the 2005 Nexus Study Update,⁴ illustrates how such an annual index could be constructed and applied to the recently adopted Affordable Housing Fees for new market rate apartment and condominium projects, for FY 2006-07. It shows, for example, that a weighted average inflation index as proposed herein

² Consistent with the City's historical experience, this assumes that most new affordable multi-family projects will be developed in multi-family districts, although some recent projects include sites in commercial districts. Unlike residential property, there is no readily available data source for commercial land price changes.

³ For example, if the average land cost for recent projects was \$3.0 million and average hard construction cost was \$9.0 million, the land to land plus construction cost ratio would be 25% ($\$3.0 \text{ million} / (\$3.0 \text{ million} + \$9.0 \text{ million})$) and the construction cost to land cost plus construction cost ratio would be 75%.


⁴ Table V-5 was based on Citywide average fees, which was one alternative fee schedule presented in the 2005 Nexus Study Update. Table 1 herein uses the alternative *weighted average* fees, which were also presented in the 2005 Nexus Study Update, and it was these fees that the City Council actually adopted on October 11, 2005.

Ron Barefield
Housing Division
City of Santa Monica
April 24, 2006

would result in a 7.9 percent annual increase, compared with a 5.2 percent increase based on construction costs alone, or 5.1 percent based on the CPI.

It is my understanding that the inflation adjustment approach described above will be presented to the City Council on May 9, 2006. We are available to assist you, as needed, with that presentation.

Sincerely,


PAUL J. SILVERN,
Partner

Ron Barefield
Housing Division
City of Santa Monica
April 24, 2006

Table 1
Affordable Housing Fee Annual Inflation Adjustment Calculations for FY 2006-07

Land Cost Inflation					
ZIP Code	Median Annual Price Change During 2005	# Condos Sold	Calculation Weights	Weighted Avg.	
90401	35.9%	27	4.5%	1.6%	
90402	-2.1%	30	5.0%	-0.1%	
90403	9.8%	237	39.5%	3.9%	
90404	25.5%	162	27.0%	6.9%	
90405	10.5%	144	24.0%	2.5%	
		600		14.8%	

Source: Los Angeles Times, Real Estate Section, p. K19, January 22, 2006 (based on DataQuick Information Systems)

Construction Cost Inflation

Engineering News Record's Construction Cost Index

March 2005 Index Value	7,309
March 2006 Index Value	7,692
Percentage Change 2005-2006	5.2%

Source: Engineering News Record (available at <http://www.enr.construction.com/features/coneco/subs/constIndexHist.asp>)

Derivation of Land Cost and Construction Cost Calculation Weights

Most Recent CCSM Family Rental Projects	Land Cost	Hard Construction	Total
1424 Broadway	\$ 3,640,000	\$ 8,100,000	\$ 11,740,000
2601 Santa Monica Boulevard	\$ 3,250,000	\$ 8,100,000	\$ 11,350,000
2209 Main Street	\$ 3,120,000	\$ 9,123,910	\$ 12,243,910
	\$ 10,010,000	\$ 25,323,910	\$ 35,333,910
	28%	72%	100%

Source: Housing Division, City of Santa Monica

Inflation Factor Derivation

	Inflation Value	Weight	Wtd. Avg.
Land Value Inflation	14.8%	28.3%	4.2%
Construction Cost Inflation	5.2%	71.7%	3.8%
			7.9%

Adjusted Fees

	Oct. 2005 Base Fees	Inflation Factor	Updated Fees	\$ Change
Condos	\$26.08	7.9%	\$28.15	\$2.07
Apartments	\$22.33	7.9%	\$24.10	\$1.77

For Information Only:

Consumer Price Index Change, LA-Riv-Or Co., All Urban Consumers

Feb. 2005 Index Value	197.4
Feb. 2006 Index Value	207.5
Percentage Change 2005-2006	5.1%

Source: US Bureau of Labor Statistics (available at: <http://www.bls.gov/cpi>)

Prepared by: Hamilton, Rabinovitz & Alschuler, Inc.