

In-Lieu Fees

Many jurisdictions allow for a developer subject to an inclusionary housing requirement to pay a fee “in-lieu of” developing affordable units. The in-lieu fee provides an alternative compliance option to provide flexibility and achieve other goals. The in-lieu fee is intended to capture all or a part of the equivalent cost to develop affordable housing. Funds collected are used by jurisdictions in a number of different ways to produce affordable housing.

Who Can Pay an In-Lieu Fee?

In-lieu fees are generally viewed as an alternative compliance option in an inclusionary ordinance, and, therefore, access to this option may be limited to certain types of projects, certain geographic areas, or to projects of a particular size. This alternative is typically intended to provide flexibility for certain projects or areas where standard construction compliance is infeasible due to land use constraints, financing or other limitations. Based on the Bay Area Economics (BAE) November 2008 Economic Analysis of our Ordinance (see your binder for the full Analysis), projects that struggle with standard compliance in Sacramento are typically smaller, dense and/or located in infill areas.

The following outlines some examples of how access to in-lieu fees is addressed in other ordinances.

1. Unlimited: Some jurisdictions (San Diego, Pasadena and Santa Rosa, for example) allow any development subject to the inclusionary ordinance to pay an in-lieu fee. These fees tend to be high, and the jurisdictions tend to have very nimble production programs to ensure fees are expeditiously spent.
2. By Product Type: The City of Berkeley allows in-lieu fees only for condominium developments, and the City of Fremont allows in-lieu fees only for large lot, low density for sale sites.
3. By Project Size: This is the most common threshold for developers to be able to pay an in-lieu fee for smaller, infill projects. Sacramento County allows fees for projects under 100 units and the City of Concord for projects under 20 acres.
4. By Geography: The City of Davis allows in-lieu fees for small projects under 15 units, but only if they are located in the downtown area.

How Much Should the Fee Be?

In-lieu fee amounts vary greatly among inclusionary ordinances. In general, in-lieu fees are calibrated to collect all or a part of the cost that the master developer would have born by constructing units. Given different product types and access to external funding, this amount can vary greatly. In a staff review of 16 ordinances in California, all but one of which included an in-lieu fee option, amounts ranged from as low as \$742 per market rate unit to as high as \$74,942 per market rate unit. As part of the 2008 economic analysis, Bay Area Economics suggested three methods for calculating an in-lieu fee.

1. Land + Cash Contribution Equivalent: This option is modeled on a market rate developer’s contribution to an affordable rental developer under typical recent partnering arrangements. It bases the in-lieu fee on the current value of improved land that the market developer donates for the construction of the rental inclusionary units, plus the amount of cash that the market developer currently contributes, on average, to their affordable housing partners. This option would create the greatest parity in terms of the financial contributions

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- required of larger developers and the smaller developers and would equal approximately **\$7,000 per market rate unit** under 2008 market conditions.
2. Affordable Rental Unit Financing Gap: This option calculates the in-lieu fee on cost to build an affordable rental unit, less the typical non-local financing that affordable rental projects can attain through debt and equity. This option is approximately equal to the amount of local “gap” funds needed in a typical new construction project. At the time of the 2008 assessment, this option resulted in an in-lieu fee of **\$24,400 per market rate unit**.
 3. For-Sale Affordable Price Write Down: This calculation bases the in-lieu fee on the difference between the cost to build a market-rate unit (without developer profit) and the maximum affordable sales price allowed. It assumes that two-thirds of the inclusionary requirement is targeted to very low-income households and one-third is targeted to low-income households, per the current ordinance. At the time of the 2008 assessment, this option resulted in an in-lieu fee of **\$32,800 per market rate unit**.

BAE recommended the \$7,000 per market rate unit fee as the most appropriate approach, which is roughly the equivalent contribution by large developers partnering to build inclusionary rental units. By pegging the fee to this most typical compliance “cost”, the in-lieu fee would be able to provide some equivalency between large developers who can access partnerships and small developers who cannot.

What Should the Fee be Used For?

Because in-lieu fees are assessed through local ordinances, their uses can be aligned to best meet the needs of the local community. As long as the fee is used to further the availability of affordable housing per the goals of the inclusionary ordinance, fees can be used for mortgage assistance, development of new rental housing or rehabilitation of affordable housing. In Sacramento, potential uses of an in-lieu fee include:

- Establishment of a “buy-down” program of very-low income units to extremely-low income levels in new multi-family rental housing developments. Fees would be used to provide subsidy to developers of affordable rental housing to deepen the affordability of very-low income units. The “buy-down” amount would be equal to the additional subsidy required to make a very-low income unit affordable at extremely-low income levels, assuming other (non-local) funding programs are accessed.
- Establishment of a fund to provide shared equity to owners of inclusionary homeownership units. A challenge of affordable homeownership is the conflict between long term affordability, which requires that the initial “subsidy” (difference between market and affordability) stay in the home for the long term and the homeowner’s ability to realize appreciation. Should the City wish to allow some access to market appreciation *and* maintain the home as affordable for some period of time, funds would be required to allow provide the equivalent market appreciation upon re-sale as if the home were sold on the open market. There are many ways this could be structured and will be discussed in a future meeting.
- Establishment of a fund to supplement existing resources for development of new inclusionary rental developments. Funds could specifically provide for additional services for the residents of these developments.