### BMR PROGRAM UPDATE
Summary of Policy Changes Recommended for Council Review and Action or Direction for Further Study  
March 17, 2008 – City Council [CMR:173:08]

<table>
<thead>
<tr>
<th>Policy #</th>
<th>Policy</th>
<th>Supported By:</th>
<th>Implementation</th>
<th>Staff Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goal #1: Improve the Current BMR Program</td>
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<tr>
<td>1. a.)</td>
<td>Recommendations Related to Appreciation and Calculation of the Resale Price; Continue to Emphasize the Goal of Permanent Affordability of BMR Units</td>
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</tbody>
</table>
| 1. a    | Change to the full CPI appreciation rate going forward from the adoption date for new BMR units and for all existing BMR units that currently have the one-third CPI formula; Include a cap on the maximum resale value | PTC, P & S, Staff, PAHC Board    | - Policy by Council resolution  
- Owners will get higher price when they sell  
- Change to deed restrictions to be used in future BMR sales transactions | Staff supports: The change to full CPI with caps going forward is consistent with continued affordability for a range of household incomes |
| 1. a.) 1| Grant retroactive appreciation at the full CPI formula to current BMR owners of units that currently have the one-third CPI formula from the date of purchase. | PTC                              | - Policy by Council resolution  
- Owners will get higher price when they sell | Staff opposes retroactive increases in appreciation; Staff supports the incentive maintenance credit proposed in the staff report |
| 1. a.) 2| Include the 17 Birch Court Discount units [these have a two-thirds CPI formula] in change to the full CPI formula going forward and retroactively for current BMR owners | PTC                              | - Policy by Council resolution  
- Owners will get higher price when they sell | Staff opposes: It is very likely these 17 units will not be sellable to qualified BMR buyers with Full CPI & thus will be lost from the BMR housing inventory, unless City buys their value back down |
<table>
<thead>
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</table>
| 1. a.) 3 PTC | Resale prices should be capped at the lesser of a price calculated: a) Using 4% appreciation compounded annually; or b) the then current BMR price for a newly built unit of that category & type assuming 20% down payment | PTC, Staff | - Policy by Council resolution  
- Cap will be used by PAHC in calculating resale price at sale  
- Changes needed to deed restrictions to be used in future BMR sales transactions | Staff supports the use of caps on the resale in combination with the change to full CPI; Using two caps should ensure resale units remain affordable and sellable |
| 1. a.) 4 PTC | Resale prices should be increased by the amount of a Special Assessments by the Homeowners Association on a BMR unit, but without any increase by the CPI and no reduction for depreciation | PTC, Staff | - Policy by Council resolution  
- Change to deed restrictions to be used in future BMR sales transactions | Staff supports: This is current policy & is applied to all units; 1984 & later deed restrictions contain this language |
| 1. a.) 5 | No depreciation of the cost of capital improvements, if they are in a state of good repair at resale | PTC | - Policy by Council resolution  
- Change to deed restrictions to be used in future BMR sales transactions | Staff opposes: No deduction at all for age does not seem reasonable; Staff proposes a simplified & very liberal depreciation schedule for common improvements & the condition could be considered; Needs further study |

**1. b**

**Recommendations on the Term of the Ownership BMR Deed Restrictions & Rental BMR Regulatory Agreements**

| 1. b.) 1 | Increase the term from the current 59 years to 89 years  
Note: The new, 89 year term would not apply to current BMR homeowners | P & S, PTC, Staff | - Policy by Council resolution  
- Change to deed restrictions to be used in future BMR sales transactions & BMR regulatory agreements on future rental projects | Staff supports: Preservation of the City’s affordable housing stock has been a fundamental goal for over 30 years.
<table>
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<tbody>
<tr>
<td>1. b.) 2</td>
<td>Request staff evaluates the potential merits of using a “life of the project” for condo complexes and for duplexes or fee simple properties using “in perpetuity”</td>
<td>PTC</td>
<td>- Policy by Council resolution&lt;br&gt;- Change to deed restrictions to be used in future BMR sales transactions &amp; BMR regulatory agreements on future rental projects</td>
<td>Staff opposes: A specific term in years is used most commonly by other jurisdictions; Current program legal documents require that any surplus revert to the City housing fund in case a unit or project is destroyed &amp; not rebuilt.</td>
</tr>
<tr>
<td>1. c.) 1</td>
<td>Recommendations to Improve the Condition of the Existing, Older BMR Housing Stock with the Provision of Limited City Financial Assistance to Very Low Income BMR Owners of Such Units:</td>
<td></td>
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</tr>
<tr>
<td>1. c.) 1</td>
<td>Add a New Housing Element Policy on Renovation Needs of Older BMR Units</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Include in Housing Element revision</td>
<td>Staff Supports: The addition of this policy would help City qualify for any grant funds that might become available.</td>
</tr>
<tr>
<td>1. c.) 2</td>
<td>Continue Pilot Program to Use Higher Resale Price to Fund Deferred Maintenance and Replacements by the New Buyer at Resale on an Interim Basis</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Include in Policy &amp; Procedures Manual</td>
<td>Staff Supports: Adoption of the Home Maintenance &amp; Replacements Credit and the Renovation Loan Program would lessen the need for this practice over time.</td>
</tr>
<tr>
<td>1. c.) 3</td>
<td>Create a Renovation Loan Program for Very Low Income BMR Owners</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Proposed for future study after implementation of other recommendations for the BMR Study [See page 7 of 9-11-08 CMR]</td>
<td>Staff Supports provided a solution can be found for workload / staffing of the program.</td>
</tr>
<tr>
<td>1. c.) 4</td>
<td>Funding for Renovation Loans</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Funding for loans is available in the Residential Housing Fund from BMR in-lieu fees and CDBG funds may also be a source</td>
<td>Staff Supports: subject to a solution to the staffing issue</td>
</tr>
<tr>
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<td>Implementation</td>
<td>Staff Comment</td>
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<td>------------------------------------------------------------------------------</td>
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<tr>
<td>1.c.) 5</td>
<td>Revise Rules regarding Maintenance, Repairs and Improvement Credits and Approval Process</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Change to deed restrictions to be used in future BMR sales transactions</td>
<td>Staff Supports</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Include new rules in Policy &amp; Procedures Manual</td>
<td></td>
</tr>
<tr>
<td>1. c.) 6</td>
<td>Require Professional Inspections and Warranty Plans (for resale units)</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Change to deed restrictions to be used in future BMR sales transactions</td>
<td>Staff Supports: While this will add some costs for buyers &amp; sellers, it will help protect all parties including the City</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Include new rules in Policy &amp; Procedures Manual</td>
<td></td>
</tr>
<tr>
<td>1.c.) 7</td>
<td>Maintain Existing Special Assessment Loan Program (but review &amp; simplify eligibility rules &amp; application procedures)</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Include new rules in Policy &amp; Procedures Manual</td>
<td>Staff Supports: In the event of further large assessment, rules &amp; process should be clearer &amp; easier to use</td>
</tr>
<tr>
<td>1. d.</td>
<td><strong>Increase Efficiency of Program Administration, Clarify Rules &amp; Improve Owner Understanding:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. d.) 1</td>
<td>Revise Resale Process to Expand Buyers’ Financing Options</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Changes needed to deed restrictions</td>
<td>Staff Supports: This is an important task to follow up on consultant recommendations so buyer can access State &amp; Fannie Mae home financing programs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>- Include new rules in Policy &amp; Procedures Manual</td>
<td></td>
</tr>
<tr>
<td>1. d.) 2</td>
<td>Continue Local Preferences and Waiting List</td>
<td>- P &amp; S, Staff</td>
<td>- Policy change by Council resolution</td>
<td>Staff Supports: The present waiting list system for buyers &amp; the two preferences of “live or work” within the City limits. Almost all buyers meet at least one preference.</td>
</tr>
<tr>
<td>1.d.) 3</td>
<td>Improve Disclosure and Continue Education</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Include new rules &amp; forms in Policy &amp; Procedures Manual</td>
<td>Staff Supports: This is an important task to follow up on consultant recommendations</td>
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<tr>
<td>1. d.) 4</td>
<td>Authority for Policy and Procedures Manual</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Adoption of a BMR ordinance</td>
<td>Task will be completed with the second reading of the ordinance adopted on 3/10/08</td>
</tr>
<tr>
<td>1. e.) 1</td>
<td>Eliminate the “Cost-Based” Pricing Exception Clause for New BMR Units in Program H-36; Continue to Base Newly Built BMR Prices Only on the Mortgage-Based Affordability Formula</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Policy direction by Council resolution - Delete with Housing Element revision</td>
<td>Staff Supports: This task follows up on consultant recommendations</td>
</tr>
<tr>
<td>1. f.) 1</td>
<td>Necessary to assist staff negotiate complex BMR agreements especially for unusual housing products; To be paid for by developers [see page 10 of P &amp; S CMR]</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Policy direction by Council resolution - Include with other future BMR ordinance amendments</td>
<td>Staff Supports: This task follows up on consultant recommendations; Being used on a case-by-case basis now.</td>
</tr>
<tr>
<td>1. g.) 1</td>
<td>Clarify the City’s Priorities for Satisfaction by Developers of the BMR Requirement</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Policy direction by Council resolution - Include in Housing Element revision &amp; future BMR ordinance amendments</td>
<td>Staff Supports: This change will assist in negotiations with developers</td>
</tr>
<tr>
<td>1. h.) 1</td>
<td>Lower the Threshold for the BMR Requirement from Five Units to Three Units or Residential Parcels</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Policy direction by Council resolution - Include in Housing Element revision &amp; future BMR</td>
<td>Staff Supports: A uniform threshold of 3 for both parcel maps &amp; new units</td>
</tr>
<tr>
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</table>
| 1.h.) 1 | Small Rental and Mixed Use Projects:  
- Use a waiver of the BMR requirement if small, modest rental units are built, rather than keeping the 5 unit threshold | P & S, PTC, Staff | ordinance amendments  
- Study in Housing Element revision process how to apply BMR requirement when a very large site | Staff Supports: Large units in small & mixed use projects should be subject to BMR in-lieu fees |
| 1.i.) 1 | Conduct Further Technical Study the BMR In-lieu Fee Formula | P & S, PTC, Staff | - Policy direction by Council resolution  
- Staff will include in future work program | Staff Supports: This task follows up on consultant recommendations |
| 1.j.) 1 | Miscellaneous Changes in Program H-36 Provisions for Incorporation into BMR Ordinance | P & S, PTC, Staff | - Policy direction by Council resolution  
- Include in Housing Element revision and / or  
- In future BMR ordinance amendments | Staff Supports: It is important to establish clear policy regarding the appropriate situations to require in-lieu fees |
| 1.j.) 2 | In-Lieu Fees for Fractional Units:  
- Clarify rules for rounding  
- Study rounding up on projects with less than 30 units | P & S, PTC, Staff  
PTC, Staff | - Policy direction by Council resolution  
- Include in Housing Element revision and / or  
- In future BMR ordinance amendments | |
| 1.j.) 3 | Subdivisions and Parcel Maps of Three of More Lots Intended for Construction of Single Family Homes: In-lieu fees should be the preferred method of satisfying the BMR requirement. | P & S, PTC, Staff | - Policy direction by Council resolution  
- Include in Housing Element revision and / or  
- In future BMR ordinance amendments | |
| 1.j.) 4 | Open Space (OS) District Projects:  
In-lieu fees should be the preferred method of satisfying the BMR requirement for OS developments | P & S, PTC, Staff | - Policy direction by Council resolution  
- Include in Housing Element revision | Staff agrees that the BMR program needs to be re-evaluated more frequently than it has been in the past |
| 1.j.) 4 | Periodic Reviews of Key Financial Levers: to keep program operating the way it was intended to | PTC | - Policy direction by Council resolution  
- Include in Housing Element revision | |

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<tbody>
<tr>
<td>1. k</td>
<td>BMR Rental Program: Specific Policy for Rental BMRs</td>
<td></td>
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<tr>
<td>1. k) 1</td>
<td>Establish More Specific Standards for Affordable Rents and Occupancy in the Proposed BMR Ordinance, but Authorize the Director to Determine Initial BMR Rents Annually</td>
<td>P &amp; S, PTC, Staff</td>
<td>- Policy direction by Council resolution</td>
<td><strong>Staff Supports:</strong> It is important to establish clear policy regarding initial rents and affordability levels of BMR rental units</td>
</tr>
</tbody>
</table>
**Goal #2: Policy Changes to Strengthen the BMR Requirement to Increase Overall Affordable Housing Production:**
Staff recommends that Council direct staff to continue to analyze the following policies (2a – 2c) as part of the upcoming Housing Element revision process. These three policies were proposed by the BMR Study consultant team.

<table>
<thead>
<tr>
<th>2. a</th>
<th>Allow Substitution of Smaller Units Only If More BMR Units Are Provided by the Developer; Otherwise BMR Units Must Meet City Comparability Standards:</th>
</tr>
</thead>
</table>
| ---  | - See page 13 of P & S CMR  
| - PTC proposed that a comparable total amount of square footage in the smaller units be required of the developer | P & S, PTC, Staff  
| - Policy direction by Council resolution to direct staff to:  
| - Study further as part of the Housing Element revision process | Staff Supports: More specific standards to use in negotiating BMR agreements involving BMR units that are substantially different from the market units |

<table>
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<tr>
<th>2. b</th>
<th>Require Land Dedication as the Default Option on Larger Sites of Three or More Acres:</th>
</tr>
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</table>
| ---  | - See pages 13-14 of P & S CMR  
| - In order for the City to continue to support non-profits in the development of very low income rental housing, creative approaches are needed, such as utilizing the BMR requirement to secure sites for rental housing | P & S, PTC, Staff  
| - Policy direction by Council resolution to direct staff to:  
| - Study further as part of the Housing Element revision process | Staff Supports: If land dedication was not feasible or appropriate, then a standard agreement of developer built units in the project would be allowed instead |

<table>
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<tr>
<th>2. c</th>
<th>Base the Minimum Number of BMR Units on the Site’s Size and Zoning Capacity:</th>
</tr>
</thead>
</table>
| ---  | - See page 14 of P & S CMR | P & S, PTC, Staff  
| - Policy direction by Council resolution to direct staff to:  
<p>| - Study further as part of the Housing Element revision process | Staff Supports: The further study and discussion of this concept. |</p>
<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Sold</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foothill Green</td>
<td>1975</td>
<td>4</td>
</tr>
<tr>
<td>Villas de San Alma</td>
<td>1975</td>
<td>8</td>
</tr>
<tr>
<td>Greenhouse II</td>
<td>1976</td>
<td>10</td>
</tr>
<tr>
<td>Channing Place</td>
<td>1976</td>
<td>2</td>
</tr>
<tr>
<td>410 Sheridan</td>
<td>1977</td>
<td>5</td>
</tr>
<tr>
<td>Villas de la Plazas</td>
<td>1978</td>
<td>4</td>
</tr>
<tr>
<td>Vista Townhouses</td>
<td>1979</td>
<td>2</td>
</tr>
<tr>
<td>San Antonio Village</td>
<td>1979</td>
<td>2</td>
</tr>
<tr>
<td>Barron Square</td>
<td>1979</td>
<td>6</td>
</tr>
<tr>
<td>Palo Alto Greens</td>
<td>1981</td>
<td>4</td>
</tr>
<tr>
<td>Colorado Place</td>
<td>1981</td>
<td>2</td>
</tr>
<tr>
<td>Palo Alto Redwoods</td>
<td>1983</td>
<td>12</td>
</tr>
<tr>
<td>Oregon Green (Offsite)</td>
<td>1984</td>
<td>1</td>
</tr>
<tr>
<td>Birch Court - BMR Units - 5</td>
<td>1984</td>
<td>22</td>
</tr>
<tr>
<td>Birch Court - Discount Units - 17</td>
<td>1984</td>
<td></td>
</tr>
<tr>
<td>Palo Alto Central</td>
<td>1984</td>
<td>7</td>
</tr>
<tr>
<td>Loma Verde Village</td>
<td>1985</td>
<td>4</td>
</tr>
<tr>
<td>Loma Verde Townhomes</td>
<td>1985</td>
<td>2</td>
</tr>
<tr>
<td>Channing Court</td>
<td>1985</td>
<td>1</td>
</tr>
<tr>
<td>Ashby Duplex</td>
<td>1985</td>
<td>2</td>
</tr>
<tr>
<td>Abitare</td>
<td>1985</td>
<td>9</td>
</tr>
<tr>
<td>Ortega Duplex</td>
<td>1986</td>
<td>2</td>
</tr>
<tr>
<td>Talisman Duplex</td>
<td>1987</td>
<td>2</td>
</tr>
<tr>
<td>Bautista Duplex</td>
<td>1987</td>
<td>2</td>
</tr>
<tr>
<td>The Hamlet</td>
<td>1988</td>
<td>6</td>
</tr>
<tr>
<td>Terrace Bay Homes</td>
<td>1988</td>
<td>2</td>
</tr>
<tr>
<td>The Rosewalk</td>
<td>1988</td>
<td>4</td>
</tr>
<tr>
<td>Ramona Courts</td>
<td>1989</td>
<td>1</td>
</tr>
<tr>
<td>Charleston Village</td>
<td>1990</td>
<td>2</td>
</tr>
<tr>
<td>737 Loma Verde (Christensen Court)</td>
<td>1992</td>
<td>1</td>
</tr>
<tr>
<td>Camino Place</td>
<td>1992</td>
<td>4</td>
</tr>
</tbody>
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# CITY OF PALO ALTO
## INVENTORY OF BELOW MARKET RATE PROGRAM UNITS (March 2008)

### BMR HOMEOWNERSHIP UNITS (Including units in development)

<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Sold</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spanish Villas</td>
<td>1993</td>
<td>1</td>
</tr>
<tr>
<td>Jacobs Court</td>
<td>1993</td>
<td>3</td>
</tr>
<tr>
<td>Promenade</td>
<td>1994</td>
<td>7</td>
</tr>
<tr>
<td>Everett Townhomes</td>
<td>1997</td>
<td>1</td>
</tr>
<tr>
<td>Silverwood - 435 Sheridan Ave.</td>
<td>1999</td>
<td>3</td>
</tr>
<tr>
<td>Classics at Barron Park (Driscoll Pl)</td>
<td>2000</td>
<td>4</td>
</tr>
<tr>
<td>Wisteria Townhomes</td>
<td>2000</td>
<td>1</td>
</tr>
<tr>
<td>800 High Condos</td>
<td>2006</td>
<td>10</td>
</tr>
<tr>
<td><strong>SUB-TOTAL (Completed Projects)</strong></td>
<td><strong>---</strong></td>
<td><strong>179</strong></td>
</tr>
<tr>
<td>Arbor Real – Under Construction / Sales in Process</td>
<td>2007-08</td>
<td>34 (plus in-lieu fees)</td>
</tr>
<tr>
<td>Vantage - Under Construction / Sales in Process (East Meadow area)</td>
<td>2007-08</td>
<td>12</td>
</tr>
<tr>
<td>Echelon – Under Construction / Sales Start Spring '08 (East Meadow area)</td>
<td>2007-08</td>
<td>11</td>
</tr>
<tr>
<td>Classics at Sterling Park – Under Construction (West Bayshore area)</td>
<td>2008-09</td>
<td>10 (plus in-lieu fees)</td>
</tr>
<tr>
<td>899 Charleston – Under Construction (CJL – senior congregate care)</td>
<td>2009</td>
<td>24</td>
</tr>
<tr>
<td>SummerHill (Elks) – Subdivision Map in Process (4249 El Camino)</td>
<td>2009</td>
<td>7</td>
</tr>
<tr>
<td>Toll Brothers – In Planning review; BMR Agreement not finalized – 7 units or in-lieu fees; (200 San Antonio Rd)</td>
<td>2009 or &gt;</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL UNITS – IN PIPELINE</strong></td>
<td><strong>---</strong></td>
<td><strong>98</strong></td>
</tr>
<tr>
<td><strong>TOTAL OWNERSHIP BMR UNITS (Completed and Pipeline)</strong></td>
<td><strong>-----</strong></td>
<td><strong>277</strong></td>
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# BMR RENTAL HOUSING UNITS

**As of March 2008**

<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Rented</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Southwood Apartments 2850 Middlefield Rd.</td>
<td>1985</td>
<td>10</td>
</tr>
<tr>
<td>1100 Welch Road Apartments</td>
<td>1987</td>
<td>11</td>
</tr>
<tr>
<td>Mayfield Apartments 345 Sheridan Ave.</td>
<td>1987 &amp; 1989</td>
<td>12</td>
</tr>
<tr>
<td>Montage Apartments 4020 El Camino Real</td>
<td>1998</td>
<td>5</td>
</tr>
<tr>
<td>Sunrise Senior Assisted Living 2701 El Camino Real</td>
<td>2006-08</td>
<td>12</td>
</tr>
</tbody>
</table>

**SUB-TOTAL – BMR RENTAL UNITS**
*(Occupied or Available for Occupancy)*

<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Rented</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>2051 El Camino Real – Under Construction</td>
<td>2008</td>
<td>1</td>
</tr>
<tr>
<td>Park Village Apts – Under Construction 1072 Tanland Dr.</td>
<td>2008</td>
<td>3</td>
</tr>
<tr>
<td>Alma Plaza – 3401 Alma St</td>
<td>Not known</td>
<td>14</td>
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**Total BMR Rental Units**
*(Occupied & Pipeline – Includes all Stanford West unit)*

<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Rented</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total BMR Rental Units</td>
<td></td>
<td>224</td>
</tr>
</tbody>
</table>

**Total All Below Market Rate Units**

<table>
<thead>
<tr>
<th>Development Name</th>
<th>Year First Rented</th>
<th>Number of BMR Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total All Below Market Rate Units</td>
<td></td>
<td>501</td>
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TO: HONORABLE CITY COUNCIL

ATTN: POLICY AND SERVICES COMMITTEE

FROM: CITY MANAGER

DATE: SEPTEMBER 11, 2007

DEPARTMENT: PLANNING AND COMMUNITY ENVIRONMENT

CMR: 350:07

SUBJECT: RECOMMEND APPROVAL OF BELOW MARKET RATE (BMR) OWNERSHIP PROGRAM UPDATE RECOMMENDATIONS

RECOMMENDATION
Staff recommends that the Policy and Services Committee review the consultants’ report (Attachment A) and staff recommendations for policy changes to the Below Market Rate (BMR) Homeownership Program, H-36 of the Housing Element of the Comprehensive Plan, and direct staff to incorporate the staff’s recommended changes (under Goal #1 of Attachment B), together with existing policy, into a new BMR ordinance and to make related changes to Program H-36 for review and adoption by the City Council. Staff also recommends that a package of implementing legal documents, including revised deed restrictions and other enforcement and disclosure documents be prepared and put into use concurrently with the effective date of the ordinance. Attachment B has a complete list of the policy changes discussed in this report. Additionally, staff is asking for Council direction to further analyze the program elements identified under Goal #2 of Attachment B as part of the next Housing Element revision.

BACKGROUND
Council first adopted BMR requirements on housing developments in 1974 as a policy in the Housing Element. Palo Alto’s program has been a success with 179 owner units and 155 rental units in the inventory, together with another 145 new owner and rental units under construction or with approvals. While the BMR program is still operating effectively, enforcement issues have become more prevalent in recent years and problems linked to the program’s age have become apparent. Staff and Palo Alto Housing Corporation (PAHC), the program administrator under contract to the City, have been implementing minor changes in rules and procedures in the BMR sales process to address specific issues over the last ten years. However, staff recognized that there was a need for an economic and policy analysis to maximize the effectiveness of the BMR program in meeting the City’s affordable housing needs. This analysis would provide expert advice about improvements in legal documents, enforcement and methods of increasing the efficiency of routine administrative procedures.
For the last 30 years, the BMR program has been governed by a short, two-page description in the Housing Element of the Comprehensive Plan. It has become increasingly the norm for communities to adopt an ordinance to govern their inclusionary housing program. In 2003, Planning and legal staff worked on the preparation of a BMR ordinance intended to codify the current policies in the Housing Element program. Several drafts of an ordinance were completed and that process helped delineate issues that needed resolution. The rigorous process of trying to codify the current Housing Element program made it clear that a number of policy decisions needed to be made before the ordinance could be finalized. Once Council provides policy direction to staff, new and existing policy can be incorporated into an ordinance and the BMR program text in the Housing Element revised to describe the broad policy parameters of the BMR program.

PAHC staff has been closely involved in the BMR Update since its inception. PAHC staff assisted Planning staff in developing the scope of services for the KMA/AA contract, met with the consultants, provided data, and reviewed and commented on drafts throughout the study. On June 26, 2007, the BMR Committee of PAHC’s Board of Directors met with City staff to discuss the final consultant report. The BMR Committee focused its discussions on the question of changing the appreciation formula and the overall policy objectives of the program. The BMR Committee supports the proposal by City staff to change from the current one-third CPI to full CPI. The Committee also supports using a methodology that: 1) prevents BMR owners from having to sell at a loss, 2) is easy to administer and explain, and 3) provides greater appreciation that the current formula. PAHC’s full Board of Directors reviewed the recommendations from the study at their meeting of July 11th and advised staff that the first priority for the City should be making improvements to the existing program. PAHC strongly supports the consultants’ recommendations for the creation of new legal documents to improve enforcement and protect the BMR housing stock.

Funds for consultant and contract staff assistance were approved by Council in the FY 2003-04 budget. In August 2004, after a competitive bidding process, Council approved a $137,085 contract with the consultant team of Keyser Marston Associates (KMA) and Anderson & Associates (AA). In addition, Planning hired a contract planner and an intern to conduct basic research on the BMR housing stock, to restructure and expand the program inventory and database, and to conduct a survey of current BMR owners. Council was briefed on the objectives and the work products of the BMR Update by the consultant team and staff at a study session held on September 27, 2004.

**Consultant Work Program:** KMA was asked to make recommendations on how the BMR requirement could be used in more creative and effective ways to help achieve the City’s broader affordable housing objectives and to increase the production of affordable owner and rental units. KMA also did an analysis of the adequacy of the BMR in-lieu fee methodology and a comparison with alternative methods. KMA was asked to recommend policies and fee methods that would increase revenues for the Residential Fund. Another key task for KMA was to evaluate the adequacy of the current BMR deed restrictions and to outline the components and content of a best practices set of legal documents as used by other cities. Finally, KMA reviewed alternatives to strict inclusionary BMR requirements with the goal of finding ways to increase affordable rental housing production and support the efforts of non-profit housing developers. Anderson Associates was a
subcontractor to KMA and provided review and advice on administrative procedures for handling the waiting list, sales and eligibility rules and methods of handling maintenance standards and capital repairs. AA also evaluated the City’s special assessment loan program, which was approved by Council in 2002.

**Owner Survey:** To obtain an objective and statistically reliable picture of the program from the perspective of the owners, a comprehensive survey questionnaire was developed. The questionnaire was sent to all BMR owners in late 2004. The response rate was excellent with 73 percent of all 169 owners completing surveys. [See Sec. 2.3 and Appendix C of the KMA / AA report for a summary and full analysis of the BMR Homeowner Survey]

Overall, a large majority of the owners are satisfied or very satisfied with their unit, their complex and the BMR program, with many owners extremely grateful for being able to participate in the program. These satisfied owners stated that without the program they would have remained a renter or would have had to leave the Bay Area to buy a home. They place a very high value on living in Palo Alto to be near their work, family or for their children to attend local schools; and on the financial stability gained from owning rather than renting. Many of the highly satisfied owners are involved in local volunteer groups, or work for the city, at Stanford, the medical clinic, in the schools or for local non-profits.

Ten to fifteen percent of all owners described themselves in the survey as “very dissatisfied” or “dissatisfied” with their unit, the complex, the neighborhood or with program rules and procedures. While almost every buyer was very pleased with the original purchase price, about one quarter of the survey respondents were dissatisfied with their projected resale price. Some owners expressed anger about being “trapped” in their unit because they cannot sell it at market rates. For various reasons, they complain that the BMR unit no longer meets their needs, but they cannot afford any other kind of ownership housing in the Bay Area. These owners often have limited options due to current income levels.

Even owners who expressed a high level of overall satisfaction with the program had concerns and suggestions for improvements. The most common concerns of BMR owners are:

- Limited appreciation under the current formula
- Rapid escalation of monthly homeowners association dues
- Fear of major special condominium assessments
- Poor condition of their unit and its appliances, especially at the time of purchase
- Issues related to owners aging in place such as reduced income due to retirement and/or the onset of a disability, or lack of handicapped accessibility
- Lack of understanding of program rules governing refinancing, calculation of the resale price, owner’s maintenance requirements, treatment of capital improvements, guidelines on rental and refinancing.
- Need or desire for a different type of home or location (need for more bedrooms, complaints about the neighborhood or the project, need for accessibility, desire for a private garden or yard or places for children to play)

**Monthly HOA Dues and Special Assessments:** The City does not have control over the rules or the
budgets of the HOAs in which BMR units are located. Condominium associations are regulated by State laws and by project-specific recorded conditions, covenants and restrictions. Each association is governed by its own board of directors elected by the owners. Monthly HOA dues have been increasing significantly each year due mainly to higher insurance costs, more stringent requirements for capital reserves and higher maintenance costs of older complexes. Problems occur because BMR owners are more sensitive to these costs than most market rate owners. There is a bill being considered in the legislature (AB 952) that would limit the size of certain dues increases and special assessments in projects with BMR units without approval of 50 percent of the BMR owners. Staff has not analyzed this bill and does not have a position on its provisions.

**BMR Property Research & Enforcement:** A product of the BMR Update is an improved database and better information about the BMR housing stock, such as its physical condition, the extent to which older units need repairs, the frequency of refinancing and the level and type of debt secured by the units. The program database, which contains statistics regarding each unit and all owners, current and past, was expanded and transferred into a different software program that can generate reports more easily.

**Problems with Financing, Excess Debt, Title and Occupancy:** The property research revealed that there were over 20 different versions of the deed restrictions used over the history of the program. Lack of uniform legal documents is an issue because it complicates enforcement efforts and creates confusion among owners as to which rules apply. For example, deed restrictions in effect prior to August 1993 permitted owners to refinance or encumber their units with additional debt without any notice to, or permission from, the City. Technically, owners that refinanced or took out equity lines of credit secured by their unit with these older restrictions did not violate the rules, even if the new loans far exceeded the unit’s limited BMR value. Fifty percent of owners responding to the survey stated they had refinanced at least once and 14 percent reported taking out an equity credit line. Deed restrictions in use since 1993 include a clause requiring City consent to any new financing, yet lenders continue to make loans on these units without requesting the City’s consent. As long as owners keep up their loan payments no harm is done, but when owners owe far more than the BMR resale value, there is a much greater likelihood of default and eventual foreclosure. There is a greater risk in these situations that a foreclosure sale could take place without the City’s knowledge resulting in the loss of the unit from the program. To date, the five BMR units that went into foreclosure were financed well in excess of their BMR value.

Research of recorded property information revealed over-financing, title transfers, or occupancy problems affecting almost 30 percent of BMR units (50 units). These problems underscore the priority of putting in place improved recorded legal documents. The use of a performance deed of trust, often used with a promissory note, to secure and enforce the provisions of the deed restrictions is becoming a more common tool to ensure that lenders, title companies and potential purchasers are fully aware of and respect a locality’s controls over these units. [Sections 4.1 – 4.3 of the consultants’ report outlines in detail the content of effective deed restrictions and related enforcement documents.]
DISCUSSION
The first issue area for Council review and action involves matters which affect the existing program and current BMR owners. These include recommendations on: the proposed change in the appreciation rate; establishing a loan program to renovate older units; confirmation of established practices and clarifications of language currently in Program H-36, together with staff’s proposal to lower the threshold for the BMR requirement to three units; and direction to staff for the completion of the ordinance and new deed restrictions and other legal documents. Secondly, Council is requested to consider proposals that will strengthen the affordable housing requirements that apply to developers, including giving direction as to which proposals should be incorporated into the new ordinance for adoption at this time, which should be studied further as part of the next Housing Element revision and which do not merit further consideration.

Goal #1: Improve Existing BMR Ownership Program
Staff recommends immediate incorporation of the following eleven policies (1A – 1K) into the new BMR ordinance.

Policy #1A: Adopt the Full CPI Appreciation Rate with a Cap on Maximum Resale Value; Continue to Emphasize the Goal of Permanent Affordability of BMR Units

*Adopt Full CPI Appreciation Rate:* Staff recommends that Council adopt the full percentage change in the CPI as the appreciation formula to calculate the resale price to replace the current one-third of the CPI formula. PAHC concurs with this recommendation. The full CPI fits well with the goal of the BMR program for permanent affordability, while still providing a reasonable financial return for owners on their downpayment. Criteria set by staff for selection of an appreciation formula were:
- Preserve long-term affordability of the BMR units for future buyers
- Increase appreciation for owners over the current one-third CPI formula
- Appreciation should be steady and fairly predictable
- Formula should be easy to explain, calculate and administer
- Avoid methods that could result in owners selling at a loss
- Keep prices for resale BMR units sufficiently below market prices and lower than prices for new BMR units

The full CPI was used in the early years of the BMR program, but extremely high inflation and interest rates during those years forced Council to act in 1983 to limit appreciation to one-third of the CPI. KMA/AA recommended that appreciation be based on the percentage change in the Area Median Income (AMI), but with floors and caps (described in Section 3.2 of the KMA / AA report and Attachment D to this staff report). Staff does not support the consultants’ proposal because it is vulnerable to the vagaries of HUD policy, which can produce extreme fluctuations, both up and down, in the AMI or lack of change at all (as occurred recently for four years in a row). Furthermore, it would be far too complicated to explain to owners and lenders and too difficult to administer. Cities that use AMI-based formulas have had many problems in recent years with owners being forced to sell at a loss due to a drop in the AMI together with an increase in interest rates.

The other commonly used system for pricing resale units is to set their prices the same way newly built units are set, using a “mortgage-based” system. This system backs into a price derived from
what a hypothetical household at the program's target income level can afford to pay given a mortgage with then-current interest rates, typical downpayment, property taxes, etc. This method is required where the housing is created under a redevelopment program and it is also how Palo Alto has always set prices for newly constructed BMR units. The drawback when it is used to set resale prices is that it can result in a loss to the selling owner if there is a level or declining AMI, or higher interest rates or HOA dues, since the calculated resale price would then be lower than the purchase price. An underlying assumption of this system is that older resale units should resell to the same general target income level as the new units. In other words, if a new unit was originally priced to be affordable to households in the 100% to 120% of AMI level, then it should remain priced at that level forever.

Palo Alto’s program, using the CPI applied to the original purchase, has resulted in BMR units becoming more affordable over the years. This has been especially true with the units under the one-third of CPI formula. This means that very low and low income households in the 40 to 80 percent of AMI range are able to afford BMR ownership of an older unit. For a four person family, these are incomes from about $42,000 to $85,000, well below Santa Clara County’s exceedingly high median income of $105,500. This result is positive in that it has broadened the types of households able to benefit from the program. The lower prices of resale units also gives the City the flexibility to absorb special assessments or other costs to preserve units faced with foreclosure in the resale prices and yet still keep the units affordable. However, to continue this trend indefinitely would eventually bring the pricing down to income levels where most households do not have sufficient financial capacity to handle the long-term demands of ownership at any cost. Returning to the full CPI index will moderate this trend.

Cap on Resale Prices: From 1986 through 2006, the annual increase of the CPI index averaged 3.3 percent and a return to the double-digit inflation and interest rates of the late 1970s and early 1980s does not seem likely in the foreseeable future. However, some kind of cap on the total rate of appreciation or on the overall maximum resale price is recommended by staff for assurance that BMR units will remain affordable. Therefore, staff recommends capping the maximum resale price for each unit type at a price that would be affordable for buyers with a 20 percent downpayment at the top (120 percent of AMI) of the moderate income bracket.

Conversion from Current Formula: If the new appreciation formula is approved by Council, it will be included in the new legal BMR documents to be prepared by the City Attorney. These documents will be put into use with new unit sales and resales of existing units as soon as the documents are ready, which should be when the ordinance is effective. Staff recommends that existing BMR owners be offered the opportunity to benefit from the new appreciation rate going forward, provided that the owners consent to the recording of the new BMR legal documents against their unit. Staff does not recommend applying the new formula retroactively because it would be unfair to those owners who sold before the change became effective.

Policy #1B: Require Essentially Permanent Affordability by Increasing the Term of the BMR Deed Restrictions and the Term of Rental BMR Regulatory Agreements from 59 Years to 89 Years

Since Palo Alto’s BMR program inception, a 59-year affordability term has been required for owner
units. The 59-year term is not mentioned in Program H-36 of the Housing Element, but it was approved for rental BMR units by Council in 1985 when the BMR program was first applied to rental projects. For owner units, the City’s practice is to place another 59-year term on a unit when a new buyer takes title, thus essentially achieving permanent affordability in most situations. In contrast, some communities use 20 or 30 year affordability terms, or even no time restrictions at all, and then lose substantial numbers of their affordable units. Because BMR homeowners have certain transfer rights without City approval, such as to a new spouse, a longer affordability term would provide greater assurance that these units will remain permanently in the City’s affordable housing stock.

While this matter was not studied by the consultants, staff found that it is becoming more common in other localities to set extended or even “permanent” affordability terms. Staff recommends that the affordability term be increased to 89 years for both owner and rental BMR units with the proposed BMR ordinance stating that the City’s objective for the 89-year term is to achieve the longest possible length of affordability for both ownership and rental BMR housing.

Policy #1C: Improve the Condition of the Existing, Older BMR Housing Stock with the Provision of Limited City Financial Assistance to Very Low Income BMR Owners of Such Units [See Section 3.3 of KMA /AA report]

Add a New Housing Element Policy: Staff recommends including in the next Housing Element revision a policy recognizing the need for rehabilitation of the older BMR ownership stock, together with a program for City financial assistance to very low income owners. With this policy and program in place, the City will be better qualified to apply for outside grant programs, should such funding become available.

Continue Pilot Program to Fund Deferred Maintenance and Replacements at Resale on an Interim Basis: Staff recommends standardizing the current pilot program of funding deferred maintenance and replacements installed by the buyer with funds from an increase in the resale price and to continue to utilize this interim strategy until new rules on maintenance, repairs and capital improvements are in place.

Create a Renovation Loan Program for Very Low Income BMR Owners: Low interest, deferred payment loans would be offered to interested owners for repairs, accessibility features, improvements and upgrades to older BMR units (defined as units 20 or more years old). The unit’s value would be increased by the amount of the loan and as an incentive to participate in the program; any capital improvements made with the loan funds would not be depreciated. The loans would be repaid at the time of resale. While information from the BMR owner survey and inspections of older units when they come up for resale indicates a real need for this type of assistance, this new program would represent a significant additional work load. Staff would not proceed with this program until after work on the BMR ordinance, legal documents and revisions to the Policy and Procedures Manual was concluded. Staff requests Council direction on whether this program is supported in concept and should be developed further.

Funding for Loans: Staff recommends funding these loans, and the administrative cost of carrying
out the loan program, from BMR in-lieu fees deposited to the Residential Housing Fund, which is a non-General Fund source. CDBG funds could also be considered as a funding source for some of these loans. A higher level of BMR in-lieu fee revenues is expected if Council adopts the staff recommendation to lower the threshold of the BMR requirement to three units and if the in-lieu fee calculation formula is updated to ensure that the fees are equivalent to the cost of the provision of actual units.

**Revise Rules Regarding Maintenance, Repair and Improvement Credits and Approval Process:** Currently, the deed restrictions contain extremely detailed rules and procedures on maintenance, repair standards and procedures for the verification and depreciation of capital improvements. Staff has found the existing rules ineffective and the procedures time consuming. These rules have served as a disincentive for repairs and improvements and have contributed to the gradual decline in the physical condition of units as they age. The proposed change to the full CPI formula will increase the rate that owners build equity, which will help owners access financing for repairs and improvements. Staff proposes that the deed restrictions contain only general language regarding maintenance, repairs and improvements with more specific details to be contained in the Program policy and procedures manual.

**Require Inspections and Warranty Plans:** Staff recommends mandating professional home inspections (to be paid for by the seller) and home warranty plans (to be paid for by the buyer) at resale. Currently, virtually no buyers choose to pay for a professional home inspection. Buyers sometimes mistakenly assume that the review of maintenance, minor repair needs and credits for capital improvements conducted by the City’s Real Property staff is equivalent to a professional inspection. Professional inspections will encourage sellers to address repair issues in advance of putting their unit up for resale, provide better protection for buyers and protect the City from claims and liability. Home warranty plans will help prevent buyers from having to pay for major replacements or repairs in the first year of ownership. Staff would include these requirements in the new deed restrictions or in sales procedures in the Program manual.

**Maintain Existing Special Assessment Loan Program:** The Special Assessment Loan Program was authorized by Council in September 2002 in response to major assessments at the Redwoods and Abitare. It provides deferred payment loans at three percent simple interest to owners who have no other way to pay for a major special assessment of $10,000 or more. To date, only three loans have been made under the program. The eligibility criteria for these loans were written to implement Council direction that assistance be offered on the basis of the owner’s financial need. The consultants recommended that the City relax the program’s requirements so more owners would be able to qualify for loans. However, staff does not recommend any changes to this program, but staff does concur with the consultants that a review of the eligibility criteria and some modifications to simplify the rules should be done in the event of another major assessment.

[See Section 3.4 of KMA / AA report]

**Policy #1D: Increase Efficiency of Program Administration, Clarify Rules & Improve Owner Understanding**

[See Section 5 of the KMA / AA report]
Revise Resale Process to Expand Buyers’ Financing Options: As the inventory of BMR units expands, it is important to broaden the pool of lenders willing to finance these units. Buyers would benefit from the advantageous loan programs available from CalHFA, and more lenders would participate if the City’s legal documents met Fannie Mae guidelines. These entities are now willing to accept extended affordability terms, but units still must be resold promptly. One concept is to establish a “Notice of Contemplated Sale” process so the time needed for review of a unit’s condition and capital improvements credits does not impact the resale time deadlines in the deed restrictions. Reselling or transferring a BMR unit would become a two-step process with the inspections completed, maintenance and improvements evaluated, title issues resolved and the sales price determined during the first step – after a Notice of Contemplated Sale. Then the selling owner would give the City the official Notice of Intent to Sell that starts the 90 day time period in which the buyer is identified, finds financing and closes escrow on the sale. The new Deed Restrictions will need to describe the revised resale process.

Continue Local Preferences and Waiting List: Since inception, a first preference for households that live or work in the city limits of Palo Alto has been used for the program. Almost all ownership units are sold to a buyer that meets this criteria. To apply to purchase a BMR unit, one must first be on the waiting list maintained by PAHC and, to stay on the list, one must reapply annually. Presently, there are over 500 households on the waiting list; usually units sell to someone within the first 200 names on the list. Staff and PAHC concur that the long-standing waiting list process will only be necessary for households who live or work in the city limits of Palo Alto is a fair and appropriate system for identifying potential buyers and no changes are proposed to this policy. Revisions to the Policy and Procedures Manual will be made to more clearly describe waiting list policies.

Improve Disclosure and Continue Education: The City’s consultants strongly recommended that buyers be required to sign a “plain language” disclosure document explaining the BMR deed restrictions and procedures prior to purchase. Typically, the legal counsel that prepares the deed restrictions would work with staff to prepare the disclosure. The City proposes to continue funding PAHC to conduct regular educational workshops and newsletters for the waiting list and BMR owners. Once improvements are made to the program, updated informational handouts and workshops will be needed to inform owners. Staff will work with PAHC to develop these materials.

Authority for Policy and Procedures Manual: Staff recommends that the Council delegate (through a provision in the proposed BMR ordinance) to the Director of Planning and Community Environment (Director) the authority to establish, follow and revise as needed a set of standard, written policies and procedures for program administration, which shall be contained in the revised and updated Policy and Procedures Manual. The current manual will be expanded to cover both aspects of the program administered by City staff, such as negotiations with developers; and aspects of the program managed under the contract with PAHC, such as the waiting list, the sales of new and existing units, standards for approval of transfers of title, refinancing, temporary rental and similar matters.

Policy #1E: Eliminate the “Cost-Based” Pricing Exception Clause for New BMR Units in Program H-36; Continue to Base Newly Built BMR Prices Only on the Mortgage-Based Affordability Formula
Program H-36 states that: “In all cases, the sales prices should be sufficient to cover the estimated costs to the developer of constructing the BMR unit, including financing, but excluding land, marketing, off-site improvements, and profit.” The consultants advised that they were unaware of any other cities that permitted developers to sell BMR units at anything other than prices based on affordable housing costs for the target income level. In practice, it has been rare for developers to request this provision and, due to the exclusion of land and some other costs, in those few cases where the calculations have been made, the sales prices have been about the same or lower than the prices from the affordable housing cost formula. The existing clause in Program H-36 regarding adjustments, appeals and waivers, which will also be included in the proposed BMR ordinance, provides sufficient relief for unusual situations where the application of the BMR requirement would result in severe hardship to a developer. [See Section 3.1.2 and Appendix D of KMA / AA report]

Policy #1F: Require a Customized Analysis of the BMR Obligation for Unusual Housing Product Types or Unique Proposals

Staff does not have sufficient expertise to evaluate the many unique ways developers propose to meet the BMR requirement, for example when rental BMR units are offered for an ownership project. In addition, special expertise is needed to apply the program to special housing product types such as senior assisted living or Congregate care projects. With the wide gamut of housing products subject to the BMR program and the broad range of solutions proposed by developers (smaller units, land dedication, off-site units, rental instead of for-sale, in-lieu fees, etc.), many complexities are presented that were not envisioned when the program was only being applied to modest stacked condominium projects. Similar to requiring a developer to prepare a customized traffic study, City policy should require that the developer pay for an independent analysis to evaluate the developer’s proposals and help staff and Council determine an acceptable BMR contribution in these situations. This policy was first used on a trial basis with the Bridge / BUILD project when staff had the developer prepare an analysis by an independent real estate economist to determine the number of very low income rental units needed in the Bridge project to satisfy the BMR requirement for the BUILD townhomes. Staff recommends that this policy be incorporated into the proposed BMR ordinance. [See Section 6.5.1 and Appendix E of the KMA/AA report]

Policy # 1G: Clarify the City’s Priorities for Satisfaction by Developers of the BMR Requirement

The existing text of Program H-36 lacks clarity about the priority for the alternatives that may be used to satisfy the BMR requirement. Based on past practice, Council should confirm that the City’s priorities for compliance with the BMR requirement are listed in order below, with combinations of the alternatives also permitted at the discretion of the Council:

1) Provide new affordable housing BMR units distributed throughout the development comparable in size, type and amenities to the market rate units;

2) Dedicate buildable land suitable for affordable housing construction;

3) Provide new affordable housing units, on-site or off-site, that are not comparable to the market rate units, but are equivalent in value to the provision of strictly comparable new BMR units;

4) Provide substantially rehabilitated existing affordable housing units, which are equivalent in value to the provision of strictly comparable new BMR units;
5) Payment of a one-time, in-lieu fee for ownership projects; for rental housing developments either a one-time fee or an annual in-lieu fee may be accepted.

Program H-36 states that in-lieu fee payments are to be allowed by the City when no other alternative is feasible, which is consistent with the priorities listed above. However, staff recommends that the ordinance should be drafted to allow the Director to propose to Council the payment, or partial payment, of in-lieu fees in limited instances where there is a specific use for the fees which will substantially increase the production of affordable housing.

Policy #IH: Lower the Threshold for the BMR Requirement from Five Units to Three Units or Residential Parcels

Staff recommends that the BMR ordinance establish the threshold of three or more units or parcels for the BMR requirement, which was in effect prior to 2002. While thresholds of three, five or ten units are common, many cities now apply inclusionary housing requirements to projects as small as two units and even to individual single family homes. The consultants recommended broadening the application of the BMR program by lowering, or eliminating entirely, the current threshold of five or more units. However, staff does not recommend collecting BMR in-lieu fees on single homes or on 2-unit projects. Staff instead recommends returning to the three or more unit threshold that was in place from 1990 to 2002. The responsibility and cost of addressing the City’s affordable housing problems will then be spread more equitably among more land owners, developers and users of the City’s limited supply of residential land. [See Section 6.6.4 of the KMA / AA report]

Small Rental and Mixed Use Projects: One original purpose of raising the threshold from three to five units was to encourage small rental and mixed use projects, however in some cases the housing units produced have been very large, over 3,000 square feet condos. Rather than keeping the current five unit threshold, Staff recommends that the BMR requirement for rental housing and mixed use projects with up to six units (six units is just below the level of seven units where, with the basic 15 percent BMR requirement, one BMR unit is needed) could be waived, provided that the units are rentals and their size is within certain modest standards which would be set in the BMR ordinance.

Difference between Threshold for Lots and Units: With the 2002 Housing Element, the threshold in Program H-36 for lots was left at three and for units it was increased to five. This change has resulted in confusion. The present system also motivates developers to split projects into separate applications to minimize the BMR obligation. Staff also recommends that language be included in the proposed BMR ordinance to base the threshold and BMR requirement percentage on the original size of a site at the time development is initiated, so that the BMR requirement for a large site is not reduced merely by dividing the site into smaller parcels for development by different entities in cases when the entitlements are being reviewed and processed concurrently.

Policy # II: Conduct Further Technical Study the BMR In-lieu Fee Formula

In-lieu fees are most often used by the City for developments of single family detached and luxury housing. Fees are also accepted for fractional units and for small projects that do not owe a full BMR unit. The current fee rate is simply one-half of the BMR percentage requirement times the
sales or appraised value of the market rate units. The consultant advised staff that our present BMR in-lieu fee methodology results in fees that are considerably lower in cost to the developer than the delivery of BMR units, when applied to projects with higher sales values and to luxury housing. KMA evaluated the accuracy of this formula compared to the financial benefit to the developer of not having to provide BMR units for various types and prices of housing, and compared the City’s system to other common methods used by other localities. Additional analysis could enable the City to collect higher fees and generate more revenue for developing affordable housing. Staff recommends that additional consultant analysis be done to examine the fee methodology and alternatives to ensure that it is fully justifiable and equitable. However, to avoid delay in adoption of the BMR ordinance the current in-lieu fee methodology should be incorporated into the ordinance at this time. [See Section 6.2 and 6.46 of the KMA /AA report]

Policy # 1J: Miscellaneous Changes in Program H-36 Provisions for Incorporation into BMR Ordinance

In-Lieu Fees for Fractional Units: In-lieu fees are currently permitted for very small projects that owe less than one full BMR unit and for fractional units owed for projects of less than 30 units unless the developer agrees to an adjustment in the type or size of the BMR units to cover the fractional unit. Staff recommends that the BMR ordinance clarify that for large projects, a fractional unit of less than 0.5 shall be covered by adjusting the type or size of the BMR units to eliminate the need to pay in-lieu fees.

Subdivisions and Parcel Maps of Three of More Lots Intended for Construction of Single Family Homes: Program H-36 currently states that the BMR requirement for single family land divisions must be met with the dedication of buildable parcels to the City or the construction of BMR units within the subdivision, unless this is infeasible. Also, while past practice has been to require in-lieu BMR fees on the future homes built on these lots, Program H-36 does not clearly state this is a requirement. Due to the extremely high values of single family lots and new, detached homes, requiring BMR in-lieu fees is the most practical alternative for meeting the BMR obligation in most situations. Staff recommends that the BMR ordinance should state that the preferred alternative for single family homes and land subdivisions is the payment of in-lieu fees. The in-lieu fees would be based on the appraised value of the lots as ready to build, fully improved lots and on the value of the future homes, to be paid when the homes are constructed and sold.

Open Space (OS) District Projects: Staff recommends that the ordinance clarify that affordable housing construction is not considered feasible in the OS district and thus the payment of in-lieu fees will be required in all cases for projects located with the OS zoning district, including land subdivisions subject to the BMR requirement.

Policy # 1K: BMR Rental Program: Establish More Specific Standards for Affordable Rents and Occupancy in the Proposed BMR Ordinance but Authorize the Director to Determine Initial BMR Rents Annually

Affordability Standards for BMR Rentals: The consultants’ recommendations focused entirely on the BMR home ownership program. However, the proposed BMR ordinance will also need to set
overall policy for the BMR rental program. The current text of Program H-36 is not specific about the affordability of BMR rental units. Due to the volatile nature of the rental market, more flexibility is needed for the Director to set initial affordability levels for BMR rents. The ordinance should implement current staff procedures which require all initial BMR rents to be at least 25 percent below market rents for comparable units and locations and that 20 to 30 percent of total BMR rental units in a project be at the very low income affordability level.

Goal #2: Policy Changes to Strengthen the BMR Requirement to Increase Overall Affordable Housing Production

Staff recommends that Council direct staff to continue to analyze the following policies (2A - 2C) and return to Council with recommendations or additional policies to either incorporate later into the proposed BMR ordinance or into the next Housing Element revision.

Policy # 2A: Allow Substitution of Smaller Units Only If More BMR Units Are Provided by the Developer; Otherwise BMR Units Must Meet City Comparability Standards

Since the program’s inception, there has been a policy that BMR units should be comparable to the market rate units, but that policy has not been consistently enforced. Written standards for both owner and rental BMR units were put in place about ten years ago by staff and since then, they have been more consistently applied. As a result, BMR units in projects presently in the pipeline are provided in proportion and comparability in type, size, number of bedrooms and location to the market rate units. The consultants’ report includes a set of formulae to calculate equivalence between different unit types of for-sale housing. If a developer proposes an alternative for consideration, then a customized analysis should be required of the developer to determine that at least an equivalent BMR contribution is obtained by the City. At times, there may be good reasons for a larger variety of units for the BMR market than are produced by developers in their projects. Staff recommends that a policy be developed allowing the substitution of different unit types and sizes for the BMR units, provided adjustments are made in the number of BMR units provided, with the standards for the equivalence included in the Policies and Procedures Manual.
[See Section 6.3 of the KMA / AA report]

Policy #2B: Require Land Dedication as the Default Option on Larger Sites of Three or More Acres

The purpose of this policy is for the City to obtain land to then provide to non-profit housing developers willing to build subsidized rental housing. Palo Alto’s BMR program has always allowed and encouraged voluntary offers of land, instead of inclusionary, on-site units. However, developers have only rarely been willing to provide land or even to construct rental units on their own land either on or off site. Any land dedication to meet the BMR requirements must be provided with appropriate zoning in place and must be a buildable, legal parcel free of environmental impediments. All impact fees and other exactions must be paid. The site must be adequate in all respects for, at a minimum, the construction of the number of rental housing units, equivalent in size to the required inclusionary BMR units. While land dedication is more likely to be practical on sites of five or more acres, some sites as small as three acres could provide a half acre parcel, which would be sufficient for a small rental development. If land dedication was infeasible or undesirable for a particular project, then the developer could contribute an equivalent piece of land at another location or the
BMR agreement would revert to the standard inclusionary type of agreement. If Council supports this policy, staff recommends that further refinement and study be completed and the program framework brought back to Council for approval as part of the next Housing Element revision. This will avoid delaying the adoption of the BMR ordinance.
[See Section 6.5.3 & 6.6.3 of the KMA/AA report]

Policy #2C: Base the Minimum Number of BMR Units on the Site’s Size and Zoning Capacity

Currently, the number of BMR units provided is a function of the total number of units actually built by the developer. Almost all residential projects are built at much less than the zoned density of the land due to the greater profitability of larger homes and the strong market for for-sale homes or townhomes on separate lots. By fixing the minimum number of BMR units in advance on a parcel basis using an objective, mathematical calculation, the City could be assured of a more predictable level of affordable housing production. Land owners, developers, and potential buyers would know with certainty the affordable housing requirement for any residentially zoned site. Some small discount could be made from the theoretical maximum density to account for the effect of development standards on unit yield. Further study would be needed regarding the application of this policy to mixed use projects and to projects under Planned Community zoning. Since this policy would encourage development of sites at the high end of the density range, staff recommends that further analysis and refinement of this concept be included in the work program for the upcoming Housing Element revision. [See Section 6.4.4 of the KMA/AA report]

BOARD AND COMMISSION REVIEW
Human Relations Commission (HRC): On December 14, 2006, the HRC discussed the recommendations in the consultants’ report with Planning staff in a study session format. A representative of PAHC also attended. The HRC members expressed a broad range of widely differing opinions about the fundamental objectives of the BMR ownership program. Generally, the HRC was supportive of the consultants’ recommendations; but did not specifically act on the report or on any particular policy recommendations. The HRC is primarily concerned about the BMR ownership program from the standpoint of the individual owner, especially owners who have financial problems or other unique situations. A few BMR owners have appealed at various times to the HRC about the hardship of monthly HOA dues and the low level of appreciation under the one-third of CPI formula.

Planning and Transportation Commission (PTC): The PTC will review any proposed BMR ordinance and make recommendations to Council on its adoption.

RESOURCE IMPACT
Funds are available and budgeted in FY 2007-08 in the Residential Housing Fund for the cost of contract legal services to assist staff with the preparation of both a BMR ordinance and with the development of new BMR ownership deed restrictions and related enforcement documents.

Implementation of the portion of Policy #1C: “Create a Renovation Loan Program for Very Low Income BMR Owners” will require both additional financial and staff resources. The financial resources could come from a higher and more predictable revenue stream from expanded application
of BMR in-lieu fees and possibly from CDBG funds for the loans. Further analysis of alternatives for administering the loan program will be conducted during the BMR in-lieu fee analysis, if Council supports the program in concept.

POLICY IMPLICATIONS
The overall focus of the BMR Study was to identify policies and procedures which would make the BMR program a more effective and efficient tool to address Palo Alto’s affordable housing needs. Broad housing policies were examined as well as mundane procedural matters in administration of BMR unit sales. Several of the new policies from the study are based on two common underlying principles:

1) New residential expansion and development should contribute at some level towards solutions to the City affordable housing problems; and

2) The BMR program should contribute more effectively to the creation and preservation of affordable rental housing to a much greater degree than in the past.

A rewrite of the BMR Program sections of the Housing Element as well as adoption of a new BMR ordinance would more clearly support these two guiding principles of the BMR Program.

TIMELINE
The timeline for Council review and action on the policy changes to the BMR Program are dependent upon the time required to prepare the BMR ordinance following Council direction. Concurrently with the drafting of a new ordinance, Planning and legal staff will need to work on the proposed changes to the deed restrictions and Policies and Procedures Manual. The existing language in the BMR Program H-36 of the Housing Element will also need to be modified and an amendment to the Housing Element adopted by Council concurrent with the adoption of the BMR ordinance.

A tentative schedule is proposed as follows:
September 11th  
Action by Policy and Services Committee on Proposed Changes
Sept – Dec. 2007  
Preparation of Ordinance & Environmental Review Process
January 2008  
PTC Review of the BMR Ordinance and Related Changes to Program H-36 of the Housing Element
March 2008  
City Council Adopts BMR Ordinance, including policy changes and related Housing Element Amendments
May 2008  
City Attorney Completes New Legal Documents (deed restrictions, deed of trust) & Revisions Completed by Planning & PAHC to Policy and Procedures Manual

ENVIRONMENTAL REVIEW
The administration of the BMR housing program is categorically exempt under Section 15326 of the California Environmental Quality Act (CEQA). However, the adoption of an ordinance to implement the BMR program will require CEQA review.
ATTACHMENTS
A. Below Market Rate Housing Program Economic / Policy Analysis and Recommendations
Prepared by Keyser Marston Associates, Inc. and Anderson & Associates (includes Appendix C: Summary and Analysis of Homeowners Survey) [Hard copies to Council and CDs to public]
B. Summary List of Staff Recommended Actions for Council Approval
C. Inventory of BMR Units [Completed and Occupied Units and Pipeline]
D. Description of Appreciation Formula Recommended by KMA

CC: Palo Alto Housing Corporation, Marlene Prendergast, Executive Director
Bonnie Packer, Palo Alto Housing Corporation Board of Directors
Lani Wheeler, Palo Alto Housing Corporation Board of Directors
Silicon Valley Association of Realtors 19400 Stevens Creek Blvd. #100, Cupertino, CA 95014
Home Builders Association of Northern California, Southern Division
Attn: Beverly Bryant 675 North First Street, Suite 620, San Jose, CA 95112-5118
Agenda posted according to PAMC Section 2.04.070. A binder containing supporting materials is available in the Council Chambers on the Friday preceding the meeting.

Special Meeting
March 17, 2008

COUNCIL CONFERENCE ROOM - 6:00 PM

ROLL CALL

1. Joint Meeting with Senator Joe Simitian Concerning State and Local Issues

COUNCIL CHAMBERS - 7:00 PM

CLOSED SESSION

2. CONFERENCE WITH LABOR NEGOTIATOR

Agency Negotiator: City Manager and his designees pursuant to Merit Rules and Regulations (Frank Benest, Russ Carlsen, Darrell Murray, Sandra Blanch, Lalo Perez, Nick Marinaro, David Ramberg, Emily Harrison)

Employee Organization: Palo Alto Fire Chiefs’ Association

Authority: Government Code Section 54957.6(a)

SPECIAL ORDERS OF THE DAY

3. Proclamation for AMGEN Tour of California

4. Adoption of a Resolution Commending the Outstanding Public Service of Sandra Hirsh as a Member of the Library Advisory Commission

5. Adoption of a Resolution commending the Outstanding Public Service of Lenore Jones as a Member of the Library Advisory Commission
ORAL COMMUNICATIONS
Members of the public may speak to any item not on the agenda; three minutes per speaker. Council reserves the right to limit the duration or Oral Communications.

APPROVAL OF MINUTES

January 22, 2008
February 4, 2008

CONSENT CALENDAR
Items will be voted on in one motion unless removed from the calendar by two Council Members.

5. Approval of Application for Membership in the Link+ Resource Sharing Library Consortium and Authorization to Participate in a Twenty-Four Month Pilot Project


AGENDA CHANGES, ADDITIONS, AND DELETIONS
HEARINGS REQUIRED BY LAW: Applications and/or appellants may have up to ten minutes at the outset of the public discussion to make their remarks and put up to three minutes for concluding remarks after other members of the public have spoken.

OTHER AGENDA ITEMS: Public comments or testimony on agenda items other than Oral Communications shall be limited to a maximum of five minutes per speaker unless additional time is granted by the presiding officer. The presiding officer may reduce the allowed time to less than five minutes if necessary to accommodate a larger number of speakers.

UNFINISHED BUSINESS

PUBLIC HEARINGS

REPORTS OF COMMITTEES AND COMMISSIONS

7. Policy and Services Committee Recommendation on Approval of Below Market Rate (BMR) Program Update Recommendations Including Alternatives for Appreciation

ORDINANCES AND RESOLUTIONS

REPORTS OF OFFICIAL

8. Adoption of Council “Top 4” Priorities and Milestones for 2008: Civic Engagement; Climate Protection; Library Plan/Public Safety Building; and Economic Health

COUNCIL MATTERS

10. Proposal to Assign to Staff to Review Pros and Cons of Requiring Public vs. Private Streets (including clearance for refuse hauling)

COUNCIL COMMENTS, ANNOUNCEMENTS, AND REPORTS FROM CONFERENCES
Members of the public may not speak to the item(s).

The meeting will adjourn and reconvene as the Public Improvement Corporation

1. Approval of 2006-07 Public Improvement Corporation Financial Statements

CLOSED SESSION
This item may occur during the recess or after the Regular Meeting.
Public Comments: Members of the public may speak to the Closed Session item(s); three minutes per speaker.

11. El Camino

ADJOURNMENT
Persons with disabilities who require auxiliary aids or services in using City facilities, services, or programs or who would like information on the City’s compliance with the Americans with Disabilities Act (ADA) of 1990, may contact 650-329-2550 (Voice) 24 hours in advance.
PLANNING & TRANSPORTATION DIVISION

STAFF REPORT

TO: PLANNING & TRANSPORTATION COMMISSION
FROM: Catherine Siegel
Advance Planning Manager
DEPARTMENT: Planning and Community Environment
AGENDA DATE: October 10, 2007
SUBJECT: Adoption of Below Market Rate (BMR) Program Update Recommendations

RECOMMENDATION
Staff recommends that the Planning and Transportation Commission recommend that the City Council:

1. Adopt the full CPI appreciation rate for new BMR units and all existing BMR units with the one-third CPI formula with a cap on the maximum resale value (Attachment A, Policy 1a); and

2. Adopt policies 1b through 1k (Attachment A) and direct staff to incorporate the changes together with existing BMR program policies into a new BMR ordinance and to make related changes to Program H-36 of the Housing Element of the Comprehensive Plan; and

3. Discuss proposed policies 2a through 2c under Goal # 2 (Attachment A) and direct staff to complete further analysis and discussion as part of the next Housing Element update.

BACKGROUND
The Policy and Services Committee held a public meeting on Tuesday, September 11, 2007 to review staff recommendations for policy changes to the City’s Below Market Rate (BMR) housing program largely based on the report prepared by the City’s consultants Keyser Marston Associates, Inc. and Anderson and Associates titled Below Market Rate Housing Program Economic / Policy Analysis and Recommendations (KMA / AA Report). The KMA / AA Report focused on the home ownership portion of the BMR program; however the staff recommendations address both existing and new policies covering the entire ownership and rental program to facilitate preparation of a BMR ordinance that addresses the entire program. Attachment A is a summary list of the policy changes and actions recommended by staff for incorporation into the future BMR ordinance or for further analysis and discussion as part of the next Housing Element update.
Courtesy notices for the Policy and Services Committee meeting were sent to current BMR owners. The Committee meeting was attended by about 25 persons consisting of BMR owners, a neighbor of a BMR unit, a member of the Human Relations Commission, a representative of the Silicon Valley Association of Realtors, staff and a board member of the Palo Alto Housing Corporation and other interested residents of Palo Alto. Six BMR owners spoke to the Committee about the program. Two owners, both with units under the one-third of CPI appreciation formula, complained about the total amount of appreciation during their term of ownership and one owner proposed that the change to the full CPI be made retroactive. Several owners were concerned about increases in their monthly homeowners’ dues. Two owners supported the proposal for a deferred loan program for renovation of older units. One owner described problems with poor maintenance of the BMR units in her complex, which was built in 1975 and has all of the BMR units located in a separate building. Two owners of BMR duplex units expressed satisfaction with their homes and were supportive of the program.

**Actions by Policy and Services Committee on the Existing BMR Program**: The Committee supported the staff recommendations labeled Policy 1b through 1k in Attachment A and recommended that the Planning and Transportation Commission recommend adoption of those policies to the City Council. The Committee discussed Policy 1a which recommends that appreciation for ownership units be increased from the current one-third of the percent change in the Consumer Price Index (CPI) to the full CPI. Although the Committee supported the change to the full CPI, it decided not to make a formal recommendation to Council. Instead the Committee referred this proposal to the Planning and Transportation Commission for further discussion and action. Particularly, the Committee requested that the Planning and Transportation Commission review and make a recommendation to the City Council on whether or not the change in the appreciation formula should be retroactive to the date each owner purchased their BMR unit. The Committee also discussed new Policies 2a, b, and c (listed under Goal #2 on page of Attachment A) and recommended that the City Council direct staff to further analyze and make recommendations on these proposals as part of the next Housing Element revision. The Committee also emphasized the need for the Planning and Transportation Commission to review and comment at this time on the viability of each of these three new policy proposals.

**DISCUSSION**

The staff report for the September 11, 2007 Policy and Services Committee is attached for background information about the BMR program, the study, the owner survey and the proposed policy changes that were supported by the Committee. This staff report focuses on discussion of the matters on which the Committee specifically requested the Planning and Transportation Commission’s input, namely:

1) The proposed change to the full CPI appreciation formula for all newly built units and for all existing units with the one-third CPI; and

2) An analysis of the ramifications of making the full CPI changes retroactive to the date of purchase for current BMR owners.

**Change to Full CPI Appreciation Formula**: Pages 5 - 6 of the September 11th staff report to the Committee discusses the circumstances which led to Council action in 1983 to change from the
original full CPI formula to one-third of the CPI. That report also describes some of the unintended benefits of the change to the one-third CPI formula from the standpoint of the BMR program as a whole, such as:

- The resale prices of BMR units becoming more affordable over time as they age and thus being available for purchase by buyers in the 40 to 80 percent of the Area Median Income (AMI) range;
- The older, resale BMR units are easier to sell because they are priced generally much lower than the newly constructed BMRs;
- The City has purchased several older BMR units to prevent their loss due to foreclosure, then renovated the units and resold them recouping the City’s legal and other costs with the resale prices on these units lower than new BMRs.

While KMA / AA only studied the period from 1988 to 2004, Section 3.2 of their report describes how the average price of attached homes sold in Palo Alto and the County Area Median Income (AMI) increased at higher rates than the CPI. Even though ownership of a BMR home would not have had as good a financial return as a market rate home, the owner, even with the one-third of the CPI formula, still has received a modest return on the cash invested and will have benefited from the income tax deductions of home mortgage interest and property taxes. For almost all BMR buyers their only alternatives to BMR ownership are to remain a renter or to leave the bay area in order to purchase any type of home. In addition, the one-third CPI formula is still acceptable to households interested in the program as evidenced by the consistently large numbers of potential buyers (usually from 500 to 600 households) on the waiting list.

The one-third CPI formula has been in effect for about 24 years now and during that time the value of the Bay Area CPI has increased from 98.4 in 1983 to about 216.0 in 2007, with the average annual change in the index being 3.2 percent. In contrast, during the first eight years of the program from 1975 to 1983, the index increased at an average annual rate of 9.6 percent. It now seems unlikely that the economic and market conditions of those early years will return. It seems reasonably clear that a return to the original full CPI formula can now be made while still preserving the long-term affordability of the BMR housing stock, especially with the inclusion of a maximum cap on the resale price. Staff believes that the full CPI formula best meets the criteria set in the BMR program study for an appreciation methodology, which were:

1) Preserve long-term affordability;
2) Encourage proper maintenance of the units;
3) Increase appreciation over the one-third of CPI;
4) Be easy to explain, calculate and administer;
5) Avoid methods that could result in owners having to sell at a loss; and
6) Keep resale prices sufficiently below market prices.

Retroactive Appreciation: The Committee specifically requested that the Planning and Transportation Commission evaluate the concept of applying any change in appreciation retroactively. Staff has concerns related to the legal, fairness and procedural aspects of a decision to adopt a retroactive change in appreciation for BMR units. The City Attorney’s Office has indicated
that there might be legal problems related to rules against a “gift of public funds” with a retroactive change. A retroactive change that only benefitted current owners would be a windfall for those owners compared to others that owned BMR units during the same general time period, but who sold before the change in the rules became effective. An owner that sold in recent years and received the one-third CPI appreciation might challenge a City policy that gave their neighbor BMR owner a sales price that was three times higher. If all past and present owners of one-third CPI units were to get a retroactive increase, the implementation would be very expensive and difficult and time consuming to administer. While current owners can be given the higher appreciation simply by increasing the sales price to the next BMR buyer, the City would need to provide the funding to compensate past owners for any retroactive appreciation. BMR units are continually offered for resale, with from 5 to 10 resales taking place in most years, the past owners who could come forward demanding equal treatment with current owners is a large number. Just locating previous BMR owners who sold one-third CPI units over the last 24 years would be quite a task in itself.

An alternative idea to a retroactive change in the appreciation formula is a one-time bonus (staff suggests $25,000) that would be added to the resale price if a unit over 10 years old is in good to excellent condition when it is offered for resale. The bonus would be in addition to any normally allowed credits for the depreciated cost of capital improvements as provided for in the deed restrictions. To receive this bonus in sales proceeds, the BMR interior of the unit would need to be in good condition; this could include fresh paint, all needed repairs completed, all floor coverings, appliances, cabinets, counter tops, kitchen and bath fixtures and heating systems clean, in good repair, and with half the components’ useful life remaining. There are other communities that provide similar financial incentives at resale to owners for exceeding the minimum standards for maintenance and capital improvements. Staff supports this type of incentive system rather than automatically providing all current owners with additional appreciation on a retroactive basis because this provides a strong incentive and reward for good maintenance and for improvements. Such an incentive system would also help to bring the older BMR housing stock into better physical condition for the benefit of subsequent BMR owners.

Staff recommends that any changes to the resale price calculation be effective going forward from the date of adoption by the City Council and that no retroactive changes be made in the appreciation formula. Existing BMR owners should be required to accept the new, revised deed restrictions that will be developed by the City Attorney as a condition of receiving the recommended full CPI appreciation formula. The revised deed restrictions and related enforcement documents will ensure the preservation of units in the program and make enforcement of the program’s rules more effective and cost efficient. The new legal documents will prevent problems such as over financing, transfer or sales without City consent, foreclosure sales without notice to the City and other serious problems. The deed restrictions are recorded as an exhibit to the grant deed to each BMR unit and include the resale price calculation with the one-third CPI method.

Three New BMR Program Policies: These proposals are explained and discussed in more detail on pages 13 – 14 of the September 11th staff report to the Committee (Attachment B).

Goal #2: Policy Changes to Strengthen the BMR Requirement to Increase Overall Affordable Housing Production.
• Policy #2a: Allow Substitution of Smaller Units Only If More BMR Units Are Provided by the Developer; Otherwise BMR Units Must Meet City Comparability Standards

• Policy #2b: Require Land Dedication as the Default Option on Larger Sites of Three or More Acres

• Policy #2c: Base the Minimum Number of BMR Units on the Site’s Size and Zoning Capacity

• The Committee also requested that the Planning and Transportation Commission provide input to Council regarding the viability of the following three policies for further review and consideration as part of the next Housing Element revision.

ENVIRONMENTAL REVIEW
The administration of the BMR housing program is categorically exempt under Section 15326 of the California Environmental Quality Act (CEQA). However, the adoption of an ordinance to implement the BMR program will require CEQA review.

ATTACHMENTS
A) BMR Program Update: Summary List of Staff Recommended Actions for Council Approval
B) City Manager’s Report dated September 11, 2007 to Policy and Service Committee (CMR:350:07) with attachments

COURTESY COPIES
Palo Alto Housing Corporation, Marlene Prendergast, Executive Director
Bonnie Packer, Palo Alto Housing Corporation Board of Directors
Lani Wheeler, Palo Alto Housing Corporation Board of Directors
Silicon Valley Association of Realtors 19400 Stevens Creek Blvd. #100, Cupertino, CA 95014
Home Builders Association of Northern California, Southern Division
Attn: Beverly Bryant 675 North First Street, Suite 620, San Jose, CA 95112-5118

Prepared by: Catherine Siegel, Advanced Planning Manager

Reviewed by: Julie Caporgno, Chief Planning and Transportation Official

Department/Division Head Approval: ____________________________

Curtis Williams, Assistant Director
BMR PROGRAM UPDATE
Summary List of Staff Recommended Actions for Council Approval

Goal #1: Improve Existing BMR Program
Staff recommends immediate incorporation of the following eleven policies (1a – 1k) into the new BMR ordinance.

Policy #1a: Adopt the Full CPI Appreciation Rate with a Cap on Maximum Resale Value; Continue to Emphasize the Goal of Permanent Affordability of BMR Units

Policy #1b: Require Essentially Permanent Affordability by Increasing the Term of the BMR Deed Restrictions and the Term of Rental BMR Regulatory Agreements from 59 Years to 89 Years

Policy #1c: Improve the Condition of the Existing, Older BMR Housing Stock with the Provision of Limited City Financial Assistance to Very Low Income BMR Owners of Such Units
   1) Add a New Housing Element Policy
   2) Continue Pilot Program to Fund Deferred Maintenance and Replacements at Resale on an Interim Basis
   3) Create a Renovation Loan Program for Very Low Income BMR Owners
   4) Funding for Renovation Loans
   5) Revise Rules regarding Maintenance, Repairs and Improvement Credits and Approval Process
   6) Require Inspections and Warranty Plans
   7) Maintain Existing Special Assessment Loan Program

Policy #1d: Increase Efficiency of Program Administration, Clarify Rules & Improve Owner Understanding
   1) Revise Resale Process to Expand Buyers’ Financing Options
   2) Continue Local Preferences and Waiting List
   3) Improve Disclosure and Continue Education
   4) Authority for Policy and Procedures Manual

Policy #1e: Eliminate the “Cost-Based” Pricing Exception Clause for New BMR Units in Program H-36; Continue to Base Newly Built BMR Prices Only on the Mortgage-Based Affordability Formula

Policy #1f: Require a Customized Analysis of the BMR Obligation for Unusual Housing Product Types or Unique Proposals
Policy # 1g: Clarify the City’s Priorities for Satisfaction by Developers of the BMR Requirement

Policy #1h: Lower the Threshold for the BMR Requirement from Five Units to Three Units or Residential Parcels
   1) Small Rental and Mixed Use Projects
   2) Difference between Threshold for Lots and Units

Policy # 1i: Conduct Further Technical Study the BMR In-lieu Fee Formula

Policy # 1j: Miscellaneous Changes in Program H-36 Provisions for Incorporation into BMR Ordinance
   1) In-Lieu Fees for Fractional Units
   2) Subdivisions and Parcel Maps of Three of More Lots Intended for Construction of Single Family Homes
   3) Open Space (OS) District Projects

Policy # 1k: BMR Rental Program: Establish More Specific Standards for Affordable Rents and Occupancy in the Proposed BMR Ordinance but Authorize the Director to Determine Initial BMR Rents Annually

Goal #2: Policy Changes to Strengthen the BMR Requirement to Increase Overall Affordable Housing Production

Staff recommends that Council direct staff to continue to analyze the following policies (2a – 2c) and return to Council with recommendations or additional policies to either incorporate later into the proposed BMR ordinance or into the next Housing Element revision.

Policy # 2a: Allow Substitution of Smaller Units Only If More BMR Units Are Provided by the Developer; Otherwise BMR Units Must Meet City Comparability Standards

Policy #2b: Require Land Dedication as the Default Option on Larger Sites of Three or More Acres

Policy #2c: Base the Minimum Number of BMR Units on the Site’s Size and Zoning Capacity
TO: HONORABLE CITY COUNCIL

ATTN: POLICY AND SERVICES COMMITTEE

FROM: CITY MANAGER

DATE: SEPTEMBER 11, 2007

SUBJECT: RECOMMEND APPROVAL OF BELOW MARKET RATE (BMR) OWNERSHIP PROGRAM UPDATE RECOMMENDATIONS

RECOMMENDATION

Staff recommends that the Policy and Services Committee review the consultants’ report (Attachment A) and staff recommendations for policy changes to the Below Market Rate (BMR) Homeownership Program, H-36 of the Housing Element of the Comprehensive Plan, and direct staff to incorporate the staff’s recommended changes (under Goal #1 of Attachment B), together with existing policy, into a new BMR ordinance and to make related changes to Program H-36 for review and adoption by the City Council. Staff also recommends that a package of implementing legal documents, including revised deed restrictions and other enforcement and disclosure documents be prepared and put into use concurrently with the effective date of the ordinance. Attachment B has a complete list of the policy changes discussed in this report. Additionally, staff is asking for Council direction to further analyze the program elements identified under Goal #2 of Attachment B as part of the next Housing Element revision.

BACKGROUND

Council first adopted BMR requirements on housing developments in 1974 as a policy in the Housing Element. Palo Alto’s program has been a success with 179 owner units and 155 rental units in the inventory, together with another 145 new owner and rental units under construction or with approvals. While the BMR program is still operating effectively, enforcement issues have become more prevalent in recent years and problems linked to the program’s age have become apparent. Staff and Palo Alto Housing Corporation (PAHC), the program administrator under contract to the City, have been implementing minor changes in rules and procedures in the BMR sales process to address specific issues over the last ten years. However, staff recognized that there was a need for an economic and policy analysis to maximize the effectiveness of the BMR program in meeting the City’s affordable housing needs. This analysis would provide expert advice about improvements in legal documents, enforcement and methods of increasing the efficiency of routine administrative procedures.
For the last 30 years, the BMR program has been governed by a short, two-page description in the Housing Element of the Comprehensive Plan. It has become increasingly the norm for communities to adopt an ordinance to govern their inclusionary housing program. In 2003, Planning and legal staff worked on the preparation of a BMR ordinance intended to codify the current policies in the Housing Element program. Several drafts of an ordinance were completed and that process helped delineate issues that needed resolution. The rigorous process of trying to codify the current Housing Element program made it clear that a number of policy decisions needed to be made before the ordinance could be finalized. Once Council provides policy direction to staff, new and existing policy can be incorporated into an ordinance and the BMR program text in the Housing Element revised to describe the broad policy parameters of the BMR program.

PAHC staff has been closely involved in the BMR Update since its inception. PAHC staff assisted Planning staff in developing the scope of services for the KMA/AA contract, met with the consultants, provided data, and reviewed and commented on drafts throughout the study. On June 26, 2007, the BMR Committee of PAHC’s Board of Directors met with City staff to discuss the final consultant report. The BMR Committee focused its discussions on the question of changing the appreciation formula and the overall policy objectives of the program. The BMR Committee supports the proposal by City staff to change from the current one-third CPI to full CPI. The Committee also supports using a methodology that: 1) prevents BMR owners from having to sell at a loss, 2) is easy to administer and explain, and 3) provides greater appreciation that the current formula. PAHC’s full Board of Directors reviewed the recommendations from the study at their meeting of July 11th and advised staff that the first priority for the City should be making improvements to the existing program. PAHC strongly supports the consultants’ recommendations for the creation of new legal documents to improve enforcement and protect the BMR housing stock.

Funds for consultant and contract staff assistance were approved by Council in the FY 2003-04 budget. In August 2004, after a competitive bidding process, Council approved a $137,085 contract with the consultant team of Keyser Marston Associates (KMA) and Anderson & Associates (AA). In addition, Planning hired a contract planner and an intern to conduct basic research on the BMR housing stock, to restructure and expand the program inventory and database, and to conduct a survey of current BMR owners. Council was briefed on the objectives and the work products of the BMR Update by the consultant team and staff at a study session held on September 27, 2004.

**Consultant Work Program:** KMA was asked to make recommendations on how the BMR requirement could be used in more creative and effective ways to help achieve the City’s broader affordable housing objectives and to increase the production of affordable owner and rental units. KMA also did an analysis of the adequacy of the BMR in-lieu fee methodology and a comparison with alternative methods. KMA was asked to recommend policies and fee methods that would increase revenues for the Residential Fund. Another key task for KMA was to evaluate the adequacy of the current BMR deed restrictions and to outline the components and content of a best practices set of legal documents as used by other cities. Finally, KMA reviewed alternatives to strict inclusionary BMR requirements with the goal of finding ways to increase affordable rental housing production and support the efforts of non-profit housing developers. Anderson Associates was a
subcontractor to KMA and provided review and advice on administrative procedures for handling the waiting list, sales and eligibility rules and methods of handling maintenance standards and capital repairs. AA also evaluated the City’s special assessment loan program, which was approved by Council in 2002.

**Owner Survey:** To obtain an objective and statistically reliable picture of the program from the perspective of the owners, a comprehensive survey questionnaire was developed. The questionnaire was sent to all BMR owners in late 2004. The response rate was excellent with 73 percent of all 169 owners completing surveys. [See Sec. 2.3 and Appendix C of the KMA / AA report for a summary and full analysis of the BMR Homeowner Survey]

Overall, a large majority of the owners are satisfied or very satisfied with their unit, their complex and the BMR program, with many owners extremely grateful for being able to participate in the program. These satisfied owners stated that without the program they would have remained a renter or would have had to leave the Bay Area to buy a home. They place a very high value on living in Palo Alto to be near their work, family or for their children to attend local schools; and on the financial stability gained from owning rather than renting. Many of the highly satisfied owners are involved in local volunteer groups, or work for the city, at Stanford, the medical clinic, in the schools or for local non-profits.

Ten to fifteen percent of all owners described themselves in the survey as “very dissatisfied” or “dissatisfied” with their unit, the complex, the neighborhood or with program rules and procedures. While almost every buyer was very pleased with the original purchase price, about one quarter of the survey respondents were dissatisfied with their projected resale price. Some owners expressed anger about being “trapped” in their unit because they cannot sell it at market rates. For various reasons, they complain that the BMR unit no longer meets their needs, but they cannot afford any other kind of ownership housing in the Bay Area. These owners often have limited options due to current income levels.

Even owners who expressed a high level of overall satisfaction with the program had concerns and suggestions for improvements. The most common concerns of BMR owners are:

- Limited appreciation under the current formula
- Rapid escalation of monthly homeowners association dues
- Fear of major special condominium assessments
- Poor condition of their unit and its appliances, especially at the time of purchase
- Issues related to owners aging in place such as reduced income due to retirement and/or the onset of a disability, or lack of handicapped accessibility
- Lack of understanding of program rules governing refinancing, calculation of the resale price, owner’s maintenance requirements, treatment of capital improvements, guidelines on rental and refinancing.
- Need or desire for a different type of home or location (need for more bedrooms, complaints about the neighborhood or the project, need for accessibility, desire for a private garden or yard or places for children to play)

**Monthly HOA Dues and Special Assessments:** The City does not have control over the rules or the
budgets of the HOAs in which BMR units are located. Condominium associations are regulated by State laws and by project-specific recorded conditions, covenants and restrictions. Each association is governed by its own board of directors elected by the owners. Monthly HOA dues have been increasing significantly each year due mainly to higher insurance costs, more stringent requirements for capital reserves and higher maintenance costs of older complexes. Problems occur because BMR owners are more sensitive to these costs than most market rate owners. There is a bill being considered in the legislature (AB 952) that would limit the size of certain dues increases and special assessments in projects with BMR units without approval of 50 percent of the BMR owners. Staff has not analyzed this bill and does not have a position on its provisions.

BMR Property Research & Enforcement: A product of the BMR Update is an improved database and better information about the BMR housing stock, such as its physical condition, the extent to which older units need repairs, the frequency of refinancing and the level and type of debt secured by the units. The program database, which contains statistics regarding each unit and all owners, current and past, was expanded and transferred into a different software program that can generate reports more easily.

Problems with Financing, Excess Debt, Title and Occupancy: The property research revealed that there were over 20 different versions of the deed restrictions used over the history of the program. Lack of uniform legal documents is an issue because it complicates enforcement efforts and creates confusion among owners as to which rules apply. For example, deed restrictions in effect prior to August 1993 permitted owners to refinance or encumber their units with additional debt without any notice to, or permission from, the City. Technically, owners that refinanced or took out equity lines of credit secured by their unit with these older restrictions did not violate the rules, even if the new loans far exceeded the unit’s limited BMR value. Fifty percent of owners responding to the survey stated they had refinanced at least once and 14 percent reported taking out an equity credit line. Deed restrictions in use since 1993 include a clause requiring City consent to any new financing, yet lenders continue to make loans on these units without requesting the City’s consent. As long as owners keep up their loan payments no harm is done, but when owners owe far more than the BMR resale value, there is a much greater likelihood of default and eventual foreclosure. There is a greater risk in these situations that a foreclosure sale could take place without the City’s knowledge resulting in the loss of the unit from the program. To date, the five BMR units that went into foreclosure were financed well in excess of their BMR value.

Research of recorded property information revealed over-financing, title transfers, or occupancy problems affecting almost 30 percent of BMR units (50 units). These problems underscore the priority of putting in place improved recorded legal documents. The use of a performance deed of trust, often used with a promissory note, to secure and enforce the provisions of the deed restrictions is becoming a more common tool to ensure that lenders, title companies and potential purchasers are fully aware of and respect a locality’s controls over these units. [Sections 4.1 – 4.3 of the consultants’ report outlines in detail the content of effective deed restrictions and related enforcement documents.]
DISCUSSION

The first issue area for Council review and action involves matters which affect the existing program and current BMR owners. These include recommendations on: the proposed change in the appreciation rate; establishing a loan program to renovate older units; confirmation of established practices and clarifications of language currently in Program H-36, together with staff’s proposal to lower the threshold for the BMR requirement to three units; and direction to staff for the completion of the ordinance and new deed restrictions and other legal documents. Secondly, Council is requested to consider proposals that will strengthen the affordable housing requirements that apply to developers, including giving direction as to which proposals should be incorporated into the new ordinance for adoption at this time, which should be studied further as part of the next Housing Element revision and which do not merit further consideration.

Goal #1: Improve Existing BMR Ownership Program
Staff recommends immediate incorporation of the following eleven policies (1A – 1K) into the new BMR ordinance.

Policy #1A: Adopt the Full CPI Appreciation Rate with a Cap on Maximum Resale Value; Continue to Emphasize the Goal of Permanent Affordability of BMR Units

Adopt Full CPI Appreciation Rate: Staff recommends that Council adopt the full percentage change in the CPI as the appreciation formula to calculate the resale price to replace the current one-third of the CPI formula. PAHC concurs with this recommendation. The full CPI fits well with the goal of the BMR program for permanent affordability, while still providing a reasonable financial return for owners on their downpayment. Criteria set by staff for selection of an appreciation formula were:

- Preserve long-term affordability of the BMR units for future buyers
- Increase appreciation for owners over the current one-third CPI formula
- Appreciation should be steady and fairly predictable
- Formula should be easy to explain, calculate and administer
- Avoid methods that could result in owners to selling at a loss
- Keep prices for resale BMR units sufficiently below market prices and lower than prices for new BMR units

The full CPI was used in the early years of the BMR program, but extremely high inflation and interest rates during those years forced Council to act in 1983 to limit appreciation to one-third of the CPI. KMA/AA recommended that appreciation be based on the percentage change in the Area Median Income (AMI), but with floors and caps (described in Section 3.2 of the KMA / AA report and Attachment D to this staff report). Staff does not support the consultants’ proposal because it is vulnerable to the vagaries of HUD policy, which can produce extreme fluctuations, both up and down, in the AMI or lack of change at all (as occurred recently for four years in a row). Furthermore, it would be far too complicated to explain to owners and lenders and too difficult to administer.

Cities that use AMI-based formulas have had many problems in recent years with owners being forced to sell at a loss due to a drop in the AMI together with an increase in interest rates.

The other commonly used system for pricing resale units is to set their prices the same way newly built units are set, using a “mortgage-based” system. This system backs into a price derived from
what a hypothetical household at the program’s target income level can afford to pay given a mortgage with then-current interest rates, typical downpayment, property taxes, etc. This method is required where the housing is created under a redevelopment program and it is also how Palo Alto has always set prices for newly constructed BMR units. The drawback when it is used to set resale prices is that it can result in a loss to the selling owner if there is a level or declining AMI, or higher interest rates or HOA dues, since the calculated resale price would then be lower than the purchase price. An underlying assumption of this system is that older resale units should resell to the same general target income level as the new units. In other words, if a new unit was originally priced to be affordable to households in the 100% to 120% of AMI level, then it should remain priced at that level forever.

Palo Alto’s program, using the CPI applied to the original purchase, has resulted in BMR units becoming more affordable over the years. This has been especially true with the units under the one-third of CPI formula. This means that very low and low income households in the 40 to 80 percent of AMI range are able to afford BMR ownership of an older unit. For a four person family, these are incomes from about $42,000 to $85,000, well below Santa Clara County’s exceedingly high median income of $105,500. This result is positive in that it has broadened the types of households able to benefit from the program. The lower prices of resale units also gives the City the flexibility to absorb special assessments or other costs to preserve units faced with foreclosure in the resale prices and yet still keep the units affordable. However, to continue this trend indefinitely would eventually bring the pricing down to income levels where most households do not have sufficient financial capacity to handle the long-term demands of ownership at any cost. Returning to the full CPI index will moderate this trend.

**Cap on Resale Prices:** From 1986 through 2006, the annual increase of the CPI index averaged 3.3 percent and a return to the double-digit inflation and interest rates of the late 1970s and early 1980s does not seem likely in the foreseeable future. However, some kind of cap on the total rate of appreciation or on the overall maximum resale price is recommended by staff for assurance that BMR units will remain affordable. Therefore, staff recommends capping the maximum resale price for each unit type at a price that would be affordable for buyers with a 20 percent downpayment at the top (120 percent of AMI) of the moderate income bracket.

**Conversion from Current Formula:** If the new appreciation formula is approved by Council, it will be included in the new legal BMR documents to be prepared by the City Attorney. These documents will be put into use with new unit sales and resales of existing units as soon as the documents are ready, which should be when the ordinance is effective. Staff recommends that existing BMR owners be offered the opportunity to benefit from the new appreciation rate going forward, provided that the owners consent to the recording of the new BMR legal documents against their unit. Staff does not recommend applying the new formula retroactively because it would be unfair to those owners who sold before the change became effective.

**Policy #1B: Require Essentially Permanent Affordability by Increasing the Term of the BMR Deed Restrictions and the Term of Rental BMR Regulatory Agreements from 59 Years to 89 Years**

Since Palo Alto’s BMR program inception, a 59-year affordability term has been required for owner
units. The 59-year term is not mentioned in Program H-36 of the Housing Element, but it was approved for rental BMR units by Council in 1985 when the BMR program was first applied to rental projects. For owner units, the City’s practice is to place another 59-year term on a unit when a new buyer takes title, thus essentially achieving permanent affordability in most situations. In contrast, some communities use 20 or 30 year affordability terms, or even no time restrictions at all, and then lose substantial numbers of their affordable units. Because BMR homeowners have certain transfer rights without City approval, such as to a new spouse, a longer affordability term would provide greater assurance that these units will remain permanently in the City’s affordable housing stock.

While this matter was not studied by the consultants, staff found that it is becoming more common in other localities to set extended or even “permanent” affordability terms. Staff recommends that the affordability term be increased to 89 years for both owner and rental BMR units with the proposed BMR ordinance stating that the City’s objective for the 89-year term is to achieve the longest possible length of affordability for both ownership and rental BMR housing.

Policy #1C: Improve the Condition of the Existing, Older BMR Housing Stock with the Provision of Limited City Financial Assistance to Very Low Income BMR Owners of Such Units [See Section 3.3 of KMA /AA report]

Add a New Housing Element Policy: Staff recommends including in the next Housing Element revision a policy recognizing the need for rehabilitation of the older BMR ownership stock, together with a program for City financial assistance to very low income owners. With this policy and program in place, the City will be better qualified to apply for outside grant programs, should such funding become available.

Continue Pilot Program to Fund Deferred Maintenance and Replacements at Resale on an Interim Basis: Staff recommends standardizing the current pilot program of funding deferred maintenance and replacements installed by the buyer with funds from an increase in the resale price and to continue to utilize this interim strategy until new rules on maintenance, repairs and capital improvements are in place.

Create a Renovation Loan Program for Very Low Income BMR Owners: Low interest, deferred payment loans would be offered to interested owners for repairs, accessibility features, improvements and upgrades to older BMR units (defined as units 20 or more years old). The unit’s value would be increased by the amount of the loan and as an incentive to participate in the program; any capital improvements made with the loan funds would not be depreciated. The loans would be repaid at the time of resale. While information from the BMR owner survey and inspections of older units when they come up for resale indicates a real need for this type of assistance, this new program would represent a significant additional work load. Staff would not proceed with this program until after work on the BMR ordinance, legal documents and revisions to the Policy and Procedures Manual was concluded. Staff requests Council direction on whether this program is supported in concept and should be developed further.

Funding for Loans: Staff recommends funding these loans, and the administrative cost of carrying
out the loan program, from BMR in-lieu fees deposited to the Residential Housing Fund, which is a
type-General Fund source. CDBG funds could also be considered as a funding source for some of
these loans. A higher level of BMR in-lieu fee revenues is expected if Council adopts the staff
recommendation to lower the threshold of the BMR requirement to three units and if the in-lieu fee
calculation formula is updated to ensure that the fees are equivalent to the cost of the provision of
actual units.

Revise Rules Regarding Maintenance, Repair and Improvement Credits and Approval Process:
Currently, the deed restrictions contain extremely detailed rules and procedures on maintenance,
repair standards and procedures for the verification and depreciation of capital improvements. Staff
has found the existing rules ineffective and the procedures time consuming. These rules have served
as a disincentive for repairs and improvements and have contributed to the gradual decline in the
physical condition of units as they age. The proposed change to the full CPI formula will increase
the rate that owners build equity, which will help owners access financing for repairs and
improvements. Staff proposes that the deed restrictions contain only general language regarding
maintenance, repairs and improvements with more specific details to be contained in the Program
policy and procedures manual.

Require Inspections and Warranty Plans: Staff recommends mandating professional home
inspections (to be paid for by the seller) and home warranty plans (to be paid for by the buyer) at
resale. Currently, virtually no buyers choose to pay for a professional home inspection. Buyers
sometimes mistakenly assume that the review of maintenance, minor repair needs and credits for
capital improvements conducted by the City’s Real Property staff is equivalent to a professional
inspection. Professional inspections will encourage sellers to address repair issues in advance of
putting their unit up for resale, provide better protection for buyers and protect the City from claims
and liability. Home warranty plans will help prevent buyers from having to pay for major
replacements or repairs in the first year of ownership. Staff would include these requirements in the
new deed restrictions or in sales procedures in the Program manual.

Maintain Existing Special Assessment Loan Program: The Special Assessment Loan Program was
authorized by Council in September 2002 in response to major assessments at the Redwoods and
Abitare. It provides deferred payment loans at three percent simple interest to owners who have no
other way to pay for a major special assessment of $10,000 or more. To date, only three loans have
been made under the program. The eligibility criteria for these loans were written to implement
Council direction that assistance be offered on the basis of the owner's financial need. The
consultants recommended that the City relax the program’s requirements so more owners would be
able to qualify for loans. However, staff does not recommend any changes to this program, but staff
does concur with the consultants that a review of the eligibility criteria and some modifications to
simplify the rules should be done in the event of another major assessment.
[See Section 3.4 of KMA / AA report]

Policy #1D: Increase Efficiency of Program Administration, Clarify Rules & Improve Owner
Understanding
[See Section 5 of the KMA / AA report]
Revise Resale Process to Expand Buyers’ Financing Options: As the inventory of BMR units expands, it is important to broaden the pool of lenders willing to finance these units. Buyers would benefit from the advantageous loan programs available from CalHFA, and more lenders would participate if the City’s legal documents met Fannie Mae guidelines. These entities are now willing to accept extended affordability terms, but units still must be resold promptly. One concept is to establish a “Notice of Contemplated Sale” process so the time needed for review of a unit’s condition and capital improvements credits does not impact the resale time deadlines in the deed restrictions. Reselling or transferring a BMR unit would become a two-step process with the inspections completed, maintenance and improvements evaluated, title issues resolved and the sales price determined during the first step — after a Notice of Contemplated Sale. Then the selling owner would give the City the official Notice of Intent to Sell that starts the 90 day time period in which the buyer is identified, finds financing and closes escrow on the sale. The new Deed Restrictions will need to describe the revised resale process.

Continue Local Preferences and Waiting List: Since inception, a first preference for households that live or work in the city limits of Palo Alto has been used for the program. Almost all ownership units are sold to a buyer that meets this criteria. To apply to purchase a BMR unit, one must first be on the waiting list maintained by PAHC and, to stay on the list, one must reapply annually. Presently, there are over 500 households on the waiting list; usually units sell to someone within the first 200 names on the list. Staff and PAHC concur that the long-standing waiting list process with a first preference for households who live or work in the city limits of Palo Alto is a fair and appropriate system for identifying potential buyers and no changes are proposed to this policy. Revisions to the Policy and Procedures Manual will be made to more clearly describe waiting list policies.

Improve Disclosure and Continue Education: The City’s consultants strongly recommended that buyers be required to sign a “plain language” disclosure document explaining the BMR deed restrictions and procedures prior to purchase. Typically, the legal counsel that prepares the deed restrictions would work with staff to prepare the disclosure. The City proposes to continue funding PAHC to conduct regular educational workshops and newsletters for the waiting list and BMR owners. Once improvements are made to the program, updated informational handouts and workshops will be needed to inform owners. Staff will work with PAHC to develop these materials.

Authority for Policy and Procedures Manual: Staff recommends that the Council delegate (through a provision in the proposed BMR ordinance) to the Director of Planning and Community Environment (Director) the authority to establish, follow and revise as needed a set of standard, written policies and procedures for program administration, which shall be contained in the revised and updated Policy and Procedures Manual. The current manual will be expanded to cover both aspects of the program administered by City staff, such as negotiations with developers; and aspects of the program managed under the contract with PAHC, such as the waiting list, the sales of new and existing units, standards for approval of transfers of title, refinancing, temporary rental and similar matters.

Policy #1E: Eliminate the “Cost-Based” Pricing Exception Clause for New BMR Units in Program H-36; Continue to Base Newly Built BMR Prices Only on the Mortgage-Based Affordability Formula
Program H-36 states that: "In all cases, the sales prices should be sufficient to cover the estimated costs to the developer of constructing the BMR unit, including financing, but excluding land, marketing, off-site improvements, and profit." The consultants advised that they were unaware of any other cities that permitted developers to sell BMR units at anything other than prices based on affordable housing costs for the target income level. In practice, it has been rare for developers to request this provision and, due to the exclusion of land and some other costs, in those few cases where the calculations have been made, the sales prices have been about the same or lower than the prices from the affordable housing cost formula. The existing clause in Program H-36 regarding adjustments, appeals and waivers, which will also be included in the proposed BMR ordinance, provides sufficient relief for unusual situations where the application of the BMR requirement would result in severe hardship to a developer. [See Section 3.1.2 and Appendix D of KMA / AA report]

Policy #1F: Require a Customized Analysis of the BMR Obligation for Unusual Housing Product Types or Unique Proposals

Staff does not have sufficient expertise to evaluate the many unique ways developers propose to meet the BMR requirement, for example when rental BMR units are offered for an ownership project. In addition, special expertise is needed to apply the program to special housing product types such as senior assisted living or congregate care projects. With the wide gamut of housing products subject to the BMR program and the broad range of solutions proposed by developers (smaller units, land dedication, off-site units, rental instead of for-sale, in-lieu fees, etc.), many complexities are presented that were not envisioned when the program was only being applied to modest stacked condominium projects. Similar to requiring a developer to prepare a customized traffic study, City policy should require that the developer pay for an independent analysis to evaluate the developer's proposals and help staff and Council determine an acceptable BMR contribution in these situations. This policy was first used on a trial basis with the Bridge / BUILD project when staff had the developer prepare an analysis by an independent real estate economist to determine the number of very low income rental units needed in the Bridge project to satisfy the BMR requirement for the BUILD townhomes. Staff recommends that this policy be incorporated into the proposed BMR ordinance. [See Section 6.5.1 and Appendix E of the KMA/AA report]

Policy #1G: Clarify the City's Priorities for Satisfaction by Developers of the BMR Requirement

The existing text of Program H-36 lacks clarity about the priority for the alternatives that may be used to satisfy the BMR requirement. Based on past practice, Council should confirm that the City's priorities for compliance with the BMR requirement are listed in order below, with combinations of the alternatives also permitted at the discretion of the Council:

1) Provide new affordable housing BMR units distributed throughout the development comparable in size, type and amenities to the market rate units;
2) Dedicate buildable land suitable for affordable housing construction;
3) Provide new affordable housing units, on-site or off-site, that are not comparable to the market rate units, but are equivalent in value to the provision of strictly comparable new BMR units;
4) Provide substantially rehabilitated existing affordable housing units, which are equivalent in value to the provision of strictly comparable new BMR units;
5) Payment of a one-time, in-lieu fee for ownership projects; for rental housing developments either a one-time fee or an annual in-lieu fee may be accepted.

Program H-36 states that in-lieu fee payments are to be allowed by the City when no other alternative is feasible, which is consistent with the priorities listed above. However, staff recommends that the ordinance should be drafted to allow the Director to propose to Council the payment, or partial payment, of in-lieu fees in limited instances where there is a specific use for the fees which will substantially increase the production of affordable housing.

Policy #1H: Lower the Threshold for the BMR Requirement from Five Units to Three Units or Residential Parcels

Staff recommends that the BMR ordinance establish the threshold of three or more units or parcels for the BMR requirement, which was in effect prior to 2002. While thresholds of three, five or ten units are common, many cities now apply inclusionary housing requirements to projects as small as two units and even to individual single family homes. The consultants recommended broadening the application of the BMR program by lowering, or eliminating entirely, the current threshold of five or more units. However, staff does not recommend collecting BMR in-lieu fees on single homes or on 2-unit projects. Staff instead recommends returning to the three or more unit threshold that was in place from 1990 to 2002. The responsibility and cost of addressing the City’s affordable housing problems will then be spread more equitably among more land owners, developers and users of the City’s limited supply of residential land. [See Section 6.6.4 of the KMA / AA report]

Small Rental and Mixed Use Projects: One original purpose of raising the threshold from three to five units was to encourage small rental and mixed use projects, however in some cases the housing units produced have been very large, over 3,000 square feet condos. Rather than keeping the current five unit threshold, Staff recommends that the BMR requirement for rental housing and mixed use projects with up to six units (six units is just below the level of seven units where, with the basic 15 percent BMR requirement, one BMR unit is needed) could be waived, provided that the units are rentals and their size is within certain modest standards which would be set in the BMR ordinance.

Difference between Threshold for Lots and Units: With the 2002 Housing Element, the threshold in Program H-36 for lots was left at three and for units it was increased to five. This change has resulted in confusion. The present system also motivates developers to split projects into separate applications to minimize the BMR obligation. Staff also recommends that language be included in the proposed BMR ordinance to base the threshold and BMR requirement percentage on the original size of a site at the time development is initiated, so that the BMR requirement for a large site is not reduced merely by dividing the site into smaller parcels for development by different entities in cases when the entitlements are being reviewed and processed concurrently.

Policy #1I: Conduct Further Technical Study the BMR In-lieu Fee Formula

In-lieu fees are most often used by the City for developments of single family detached and luxury housing. Fees are also accepted for fractional units and for small projects that do not owe a full BMR unit. The current fee rate is simply one-half of the BMR percentage requirement times the
sales or appraised value of the market rate units. The consultant advised staff that our present BMR in-lieu fee methodology results in fees that are considerably lower in cost to the developer than the delivery of BMR units, when applied to projects with higher sales values and to luxury housing. KMA evaluated the accuracy of this formula compared to the financial benefit to the developer of not having to provide BMR units for various types and prices of housing, and compared the City’s system to other common methods used by other localities. Additional analysis could enable the City to collect higher fees and generate more revenue for developing affordable housing. Staff recommends that additional consultant analysis be done to exam the fee methodology and alternatives to ensure that it is fully justifiable and equitable. However, to avoid delay in adoption of the BMR ordinance the current in-lieu fee methodology should be incorporated into the ordinance at this time. [See Section 6.2 and 6.46 of the KMA/AA report]

Policy # 1J: Miscellaneous Changes in Program H-36 Provisions for Incorporation into BMR Ordinance

In-Lieu Fees for Fractional Units: In-lieu fees are currently permitted for very small projects that owe less than one full BMR unit and for fractional units owed for projects less than 30 units unless the developer agrees to an adjustment in the type or size of the BMR units to cover the fractional unit. Staff recommends that the BMR ordinance clarify that for large projects, a fractional unit of less than 0.5 shall be covered by adjusting the type or size of the BMR units to eliminate the need to pay in-lieu fees.

Subdivisions and Parcel Maps of Three of More Lots Intended for Construction of Single Family Homes: Program H-36 currently states that the BMR requirement for single family land divisions must be met with the dedication of buildable parcels to the City or the construction of BMR units within the subdivision, unless this is infeasible. Also, while past practice has been to require in-lieu BMR fees on the future homes built on these lots, Program H-36 does not clearly state this is a requirement. Due to the extremely high values of single family lots and new, detached homes, requiring BMR in-lieu fees is the most practical alternative for meeting the BMR obligation in most situations. Staff recommends that the BMR ordinance should state that the preferred alternative for single family homes and land subdivisions is the payment of in-lieu fees. The in-lieu fees would be based on the appraised value of the lots as ready to build, fully improved lots and on the value of the future homes, to be paid when the homes are constructed and sold.

Open Space (OS) District Projects: Staff recommends that the ordinance clarify that affordable housing construction is not considered feasible in the OS district and thus the payment of in-lieu fees will be required in all cases for projects located with the OS zoning district, including land subdivisions subject to the BMR requirement.

Policy # 1K: BMR Rental Program: Establish More Specific Standards for Affordable Rents and Occupancy in the Proposed BMR Ordinance but Authorize the Director to Determine Initial BMR Rents Annually

Affordability Standards for BMR Rentals: The consultants’ recommendations focused entirely on the BMR home ownership program. However, the proposed BMR ordinance will also need to set
overall policy for the BMR rental program. The current text of Program H-36 is not specific about the affordability of BMR rental units. Due to the volatile nature of the rental market, more flexibility is needed for the Director to set initial affordability levels for BMR rents. The ordinance should implement current staff procedures which require all initial BMR rents to be at least 25 percent below market rents for comparable units and locations and that 20 to 30 percent of total BMR rental units in a project be at the very low income affordability level.

Goal #2: Policy Changes to Strengthen the BMR Requirement to Increase Overall Affordable Housing Production

Staff recommends that Council direct staff to continue to analyze the following policies (2A – 2C) and return to Council with recommendations or additional policies to either incorporate later into the proposed BMR ordinance or into the next Housing Element revision.

Policy # 2A: Allow Substitution of Smaller Units Only If More BMR Units Are Provided by the Developer; Otherwise BMR Units Must Meet City Comparability Standards

Since the program’s inception, there has been a policy that BMR units should be comparable to the market rate units, but that policy has not been consistently enforced. Written standards for both owner and rental BMR units were put in place about ten years ago by staff and since then, they have been more consistently applied. As a result, BMR units in projects presently in the pipeline are provided in proportion and comparability in type, size, number of bedrooms and location to the market rate units. The consultants’ report includes a set of formulae to calculate equivalence between different unit types of for-sale housing. If a developer proposes an alternative for consideration, then a customized analysis should be required of the developer to determine that at least an equivalent BMR contribution is obtained by the City. At times, there may be good reasons for a larger variety of units for the BMR market than are produced by developers in their projects. Staff recommends that a policy be developed allowing the substitution of different unit types and sizes for the BMR units, provided adjustments are made in the number of BMR units provided, with the standards for the equivalence included in the Policies and Procedures Manual.

[See Section 6.3 of the KMA / AA report]

Policy #2B: Require Land Dedication as the Default Option on Larger Sites of Three or More Acres

The purpose of this policy is for the City to obtain land to then provide to non-profit housing developers willing to build subsidized rental housing. Palo Alto’s BMR program has always allowed and encouraged voluntary offers of land, instead of inclusionary, on-site units. However, developers have only rarely been willing to provide land or even to construct rental units on their own land either on or off site. Any land dedication to meet the BMR requirements must be provided with appropriate zoning in place and must be a buildable, legal parcel free of environmental impediments. All impact fees and other exactions must be paid. The site must be adequate in all respects for, at a minimum, the construction of the number of rental housing units, equivalent in size to the required inclusionary BMR units. While land dedication is more likely to be practical on sites of five or more acres, some sites as small as three acres could provide a half acre parcel, which would be sufficient for a small rental development. If land dedication was infeasible or undesirable for a particular project, then the developer could contribute an equivalent piece of land at another location or the
BMR agreement would revert to the standard inclusionary type of agreement. If Council supports this policy, staff recommends that further refinement and study be completed and the program framework brought back to Council for approval as part of the next Housing Element revision. This will avoid delaying the adoption of the BMR ordinance. 

[See Section 6.5.3 & 6.6.3 of the KMA /AA report]

Policy #2C: Base the Minimum Number of BMR Units on the Site’s Size and Zoning Capacity

Currently, the number of BMR units provided is a function of the total number of units actually built by the developer. Almost all residential projects are built at much less than the zoned density of the land due to the greater profitability of larger homes and the strong market for for-sale homes or townhomes on separate lots. By fixing the minimum number of BMR units in advance on a parcel basis using an objective, mathematical calculation, the City could be assured of a more predictable level of affordable housing production. Land owners, developers, and potential buyers would know with certainty the affordable housing requirement for any residually zoned site. Some small discount could be made from the theoretical maximum density to account for the effect of development standards on unit yield. Further study would be needed regarding the application of this policy to mixed use projects and to projects under Planned Community zoning. Since this policy would encourage development of sites at the high end of the density range, staff recommends that further analysis and refinement of this concept be included in the work program for the upcoming Housing Element revision.  

[See Section 6.4.4 of the KMA / AA report]

BOARD AND COMMISSION REVIEW

Human Relations Commission (HRC): On December 14, 2006, the HRC discussed the recommendations in the consultants’ report with Planning staff in a study session format. A representative of PAHC also attended. The HRC members expressed a broad range of widely differing opinions about the fundamental objectives of the BMR ownership program. Generally, the HRC was supportive of the consultants’ recommendations; but did not specifically act on the report or on any particular policy recommendations. The HRC is primarily concerned about the BMR ownership program from the standpoint of the individual owner, especially owners who have financial problems or other unique situations. A few BMR owners have appealed at various times to the HRC about the hardship of monthly HOA dues and the low level of appreciation under the one-third of CPI formula.

Planning and Transportation Commission (PTC): The PTC will review any proposed BMR ordinance and make recommendations to Council on its adoption.

RESOURCE IMPACT

Funds are available and budgeted in FY 2007-08 in the Residential Housing Fund for the cost of contract legal services to assist staff with the preparation of both a BMR ordinance and with the development of new BMR ownership deed restrictions and related enforcement documents.

Implementation of the portion of Policy # 1C: “Create a Renovation Loan Program for Very Low Income BMR Owners” will require both additional financial and staff resources. The financial resources could come from a higher and more predictable revenue stream from expanded application
of BMR in-lieu fees and possibly from CDBG funds for the loans. Further analysis of alternatives for administering the loan program will be conducted during the BMR in-lieu fee analysis, if Council supports the program in concept.

POLICY IMPLICATIONS
The overall focus of the BMR Study was to identify policies and procedures which would make the BMR program a more effective and efficient tool to address Palo Alto’s affordable housing needs. Broad housing policies were examined as well as mundane procedural matters in administration of BMR unit sales. Several of the new policies from the study are based on two common underlying principles:

1) New residential expansion and development should contribute at some level towards solutions to the City affordable housing problems; and

2) The BMR program should contribute more effectively to the creation and preservation of affordable rental housing to a much greater degree than in the past.

A rewrite of the BMR Program sections of the Housing Element as well as adoption of a new BMR ordinance would more clearly support these two guiding principles of the BMR Program.

TIMELINE
The timeline for Council review and action on the policy changes to the BMR Program are dependent upon the time required to prepare the BMR ordinance following Council direction. Concurrently with the drafting of a new ordinance, Planning and legal staff will need to work on the proposed changes to the deed restrictions and Policies and Procedures Manual. The existing language in the BMR Program H-36 of the Housing Element will also need to be modified and an amendment to the Housing Element adopted by Council concurrent with the adoption of the BMR ordinance.

A tentative schedule is proposed as follows:

September 11th  Action by Policy and Services Committee on Proposed Changes
Sept. – Dec. 2007  Preparation of Ordinance & Environmental Review Process
January 2008  PTC Review of the BMR Ordinance and Related Changes to Program H-36 of the Housing Element
March 2008  City Council Adopts BMR Ordinance, including policy changes and related Housing Element Amendments
May 2008  City Attorney Completes New Legal Documents (deed restrictions, deed of trust) & Revisions Completed by Planning & PAHC to Policy and Procedures Manual

ENVIRONMENTAL REVIEW
The administration of the BMR housing program is categorically exempt under Section 15326 of the California Environmental Quality Act (CEQA). However, the adoption of an ordinance to implement the BMR program will require CEQA review.
ATTACHMENTS
A. Below Market Rate Housing Program Economic / Policy Analysis and Recommendations Prepared by Keyser Marston Associates, Inc. and Anderson & Associates (includes Appendix C: Summary and Analysis of Homeowners Survey) [Hard copies to Council and CDs to public]
B. Summary List of Staff Recommended Actions for Council Approval
C. Inventory of BMR Units [Completed and Occupied Units and Pipeline]
D. Description of Appreciation Formula Recommended by KMA

CC: Palo Alto Housing Corporation, Marlene Prendergast, Executive Director
Bonnie Packer, Palo Alto Housing Corporation Board of Directors
Lani Wheeler, Palo Alto Housing Corporation Board of Directors
Silicon Valley Association of Realtors 19400 Stevens Creek Blvd. #100, Cupertino, CA 95014
Home Builders Association of Northern California, Southern Division
Attn: Beverly Bryant 675 North First Street, Suite 620, San Jose, CA 95112-5118
ROLL CALL: 7:04 PM

Commissioners:  
- Karen Holman - Chair
- Daniel Garber - V-Chair
- Patrick Burt
- Paula Sandas
- Arthur Keller
- Lee Lippert
- Samir Tuma

Staff:  
- Curtis Williams, Assistant Director
- Julie Caporgno, Chief Plan. & Transp. Official
- Melissa Tronquet, Deputy City Attorney
- Cathy Siegel, Planner
- Lisa Green, Admin. Associate

AGENDIZED ITEMS:  
1. 2380 Embarcadero Road Temporary Relocation of Landfill Facilities Project -- Postponed  
2. 260 Homer Avenue – Continued to meeting of October 24, 2007  
3. Review of Below Market Rate (BMR) Program Update Recommendations Including Alternatives for Appreciation

Chair Holman: Good evening. I would like to call the regular meeting of the Planning and Transportation Commission for Wednesday, October 10, 2007 to order. Would the Secretary call the roll, please? Thank you, all seven members present.

This is the time when anyone who would like to speak to an item that is not on the agenda could come forward to speak. We have no cards from members of the public. I’m sorry; we do have a member of the public. I don’t have a card yet for an item not on the agenda. My apologies.

Okay, we have one member of the public then who would like to speak, Greg Kerber. You will have five minutes. Now, this says agenda item number three.

ORAL COMMUNICATIONS. Members of the public may speak to any item not on the agenda with a limitation of three (3) minutes per speaker. Those who desire to speak must complete a
one that was previously before that they would have to prepare an EIR before it comes before you.

Chair Holman: Just to be clear. Item number one has been postponed indefinitely. We do not need a motion for that because it has been postponed not continued. Is that correct?

Mr. Williams: Right, yes.

MOTION PASSED (7-0-0-0)

Chair Holman: Okay, thank you very much. So we will move to item number three now. We quickly dispensed with items one and two. We did not vote on item number two so we need a vote continuing item number two to October 24. All those in favor? (ayes) All those opposed? That passes on seven to zero vote.

So we will move now to item number three, Review of Below Market Rate or BMR Program Update Recommendations Including Alternative for Appreciation. If there are members of the public who would like to speak to this item please fill out one of these cards, which you can get from Lisa on the side over here. Staff, would you care to make a presentation? I believe Marlene Prendergast is here to be available to either make a presentation or answer questions or both. Okay, Staff?

NEW BUSINESS

Public Hearing:

3. Review of Below Market Rate (BMR) Program Update Recommendations Including Alternatives for Appreciation

Ms. Caporgno: I was going to introduce Cathy Siegel who is our Advance Planning Manager who will give the presentation tonight. She was previously the City’s Housing Coordinator and has all the expertise in housing that you would ever want.

Ms. Cathy Siegel, Advance Planning Manager: Thank you Julie for that generous introduction. We do have a PowerPoint presentation.

The question might come up, why are we studying the BMR program at this time? Why does it need attention? Well the program has been in existence since 1974, which is over 30 years of experience. Also at this time we are faced with unprecedented growth in both the BMR owner and rental units due to the numerous housing developments that are either under construction or in entitlements at this time. Presently there are 179 occupied BMR units out there. We have another 98 units in the pipeline. So you can see that is a huge rate of growth that is coming up on us.

As part of this study we did a survey in 2005 of owners and that revealed a number of concerns that the owners do have, which need to be addressed. Also, our attorneys are urging us that it is the time to move from just a Housing Element program, which is the way the BMR has been
structured since its inception to an actual ordinance. We also urgently need improved legal
documents including new deed restrictions.

This slide outlines the structure we are moving towards with an adopted ordinance. The Housing
Element program would provide a broad statement of goals and objectives. The ordinance
would provide guidance on policies, rules, and requirements of developers. Then the regulatory
restrictions would be both recorded BMR agreements that are recorded against the property
when the subdivision or development is approved and also the recorded deed restrictions that are
recorded with the Grant Deed on the individual homeowner or in the case of rental BMR units
against the owner of the rental property. Then below that in kind of an order of magnitude or
legal structure would be a policy and procedures manual which is something we do have but it
will need to be completely updated with the policy changes that are finally approved and that
will guide the daily administration of the program both the work that Palo Alto Housing
Corporation does and the work that the City does.

The study that we have worked on over the last three or four years addressed ownership program
issues including looking at that appreciation formula, current policies and practices for
preparation of a BMR ordinance including looking at polices and practices that need to be
changed, and then looking at new innovative policies that could increase the effectiveness of the
City’s BMR requirement in terms of achieving our overall affordable housing objectives.

We especially looked at issues related to the older BMR housing stock now that we have many
units that are over 20 years old or almost 35 years old. We had been finding as they come up for
resale that often there is a declining level of interior physical condition, as many owners do not
manage to take care of the maintenance or make improvements. Sometimes that is not
intentional. They would like to do that but they just don’t have the funds to do it. Some units
have been financed in excess of their BMR value and that is in part to some deficiencies in our
legal documents that have been in place. There are problems with special assessments that have
occurred and I think about four projects have had major special assessments. I have heard of two
other situations coming up where special assessments are going to be occurring again.

BMR owners tend to be people that are really dedicated to staying in Palo Alto and that is part of
the reason they get into this program. They then consequently age in place. Often as they retire,
maybe become disabled, circumstances change in their lives, their incomes end up declining.
Sometimes declining to an extent that even just paying their monthly homeowner’s dues and
taxes is a burden.

Just a quick overview. As I said we have 179 existing owner units, 12 of them are in duplexes.
They are zero lot line units where the owner owns the land and the unit and they do not have
monthly homeowner’s dues. They are responsible for all the maintenance of the unit just like in
a single family home, the roof, the siding, everything. Most of the units are not in that situation,
169 are condos. These might be condo townhouses or multi-story condo projects. In those
situations the owners pay monthly homeowner’s dues and those dues help pay for the exterior
maintenance, insurance, and things like that. In those cases the owners are responsible for the
interior maintenance, the floor coverings, the painting, the appliances, things like that.
Overall we found through our survey that the large majority of the BMR owners are satisfied with the program. We have pretty good confidence in the results of this survey. We had a 73 percent response rate on a 40-question survey and many people wrote very detailed comments in addition to just answering the questions. However, typical concerns that were revealed included dissatisfaction with the rate of appreciation in particular with the units that are under the one-third of the consumer price index or CPI formula. There is concern with the increasing monthly homeowner’s dues. Those seem to go up every year by pretty significant amounts so that many people are paying $350 or $450 a month for homeowner’s dues. Again as I mentioned, the concerns with special assessments, the cost of repairs, for many owners even just replacing their kitchen appliances is a financial burden. We also had concerns from owners about the lack incentives in the language in the deed restrictions for making repairs and things like the requirement that capital improvements be depreciated. Again as I mentioned, concerns relating to aging in place. Owners with physical disabilities that are in a unit on a third floor of a building that has no elevator access and things like that.

As was mentioned we went to Policy and Services Committee on September 11 and they referred certain items to the Planning Commission. The Council Committee did support the policy changes that the Staff recommended which are Attachment A to your Staff Report. They supported the policy changes under Goal 1 including the change to the full CPI appreciation formula but they wanted the Commission to review that proposal and provide your input also. The change to the full CPI this formula is proposed by Staff to apply going forward in time from whatever its effective date would be and we would apply it to new units as they are placed into the program and to existing units as they are resold. For the existing owners they would legally need to consent to an amendment to their deed restrictions. So the amendment would have the full CPI formula in it and would have the revised and updated language that will improve the effectiveness and enforcement ability of the City with those legal documents. So I believe that for existing owners in that situation the change would take place when those documents are actually recorded against their unit.

Here is an example of a resale price calculation with both the full CPI formula and then at the bottom it shows the calculation with the exiting one-third CPI formula that applies to most of our units now. This is a $240,000 purchase price, which is a typical one for new units being built at this time, a two-bedroom BMR unit. Hypothetically if it was owned for ten years and then sold, and what I did was took the rate of change in the Consumer Price Index that has occurred in the last ten years because obviously I wouldn’t dare predict the future. So I just assumed we would go along the way we have been going along for the last ten years, which has appreciation of about maybe three percent per year. So with a full CPI that would result in appreciation of $75,000 and a resale price of $315,000 after ten years.

If that same unit had been under the one-third CPI for that period of time and at that rate of inflation the CPI would be simply one-third of the $75,000 or $25,000. So a resale price of $265,000. So you can see the magnitude of the change there. The smaller the original purchase price the lower the magnitude but you can get the idea.

One thing that was brought up at the Policy and Services Committee was some of the BMR owners advocated for a retroactive application of the change to the full CPI and the Council
Committee discussed and debated that and there was some support for it and some argument against it. So they have specifically referred that matter to the Commission for your discussion and debate and input to the full City Council.

Staff has serious concerns about any retroactive changes in the formula that determines resale prices. We are worried about legal challenges from past owners who have already sold their BMR units and were subject to the one-third formula during their term of ownership. We have sales going on all the time. In 2006-2007 we had ten resales of existing units so there are owners out there that are still in the City and will know what has happened and they will say why don’t I get that benefit too? That kind of connects with possible legal concerns with issues with a gift of public funds. We are dealing with a pretty limited number of people here. Also we are concerned about a financial windfall that has no relationship to the condition of the unit when it is put up for sale. As I mentioned earlier some of the older units come up for sale and are in pretty poor shape. So providing additional funds to the owner that is not connected in any way with the condition of the unit doesn’t seem like the best path to take. It would also in some situations bring the resale prices of units in projects that have already experienced major special assessments up to a level where they might be difficult to sell especially if they are placed on the market in poor condition. We have a couple of projects, Redwoods and Abitare, that have very small units and they can be difficult to find buyers for even now. If their prices go up significantly it could be even more of a problem in those particular projects.

Again, from the assessed perspective it is a minority of owners that are advocating for a retroactive change. When we did our survey 90 percent of the owners that were surveyed were satisfied or very satisfied with the purchase price of their unit at the time they bought it. So most of those were purchasing units that had been appreciating at that low one-third of CPI rate. So they were happy when they bought the units for those low prices. In our survey it revealed that only eight percent of the owners expressed being very dissatisfied with the current appreciation rate. I think we had another 15 percent that were somewhat dissatisfied.

Then another thing to keep in mind is even a retroactive change for even owners that have owned all the way back to 1984 when the change was first made is still not going to help people get into the housing market in this area especially in Palo Alto. It is just not a big enough of a change to make that difference unless somebody has perhaps enough income to really afford taking their equity out of their BMR unit and maybe buying a higher priced BMR unit or taking on a large mortgage.

Now to briefly just cover some of the other recommendations that were made. We grouped our recommendations for policy changes under two goals. The first goal was to improve the existing ownership program and we had 11 policy recommendations under that goal. They are in Attachment A to your report labeled 1a through 1k. They were supported by the Policy and Services Committee and they recommend that you also act to recommend those changes to the City Council. Under Goal 2 we looked at new policies that we thought would be innovative ways of strengthening the BMR requirement and thus increasing our affordable housing production. The Policy and Services Committee supported further study of these policies as part of the next Housing Element revision but requested the Commission’s review, comments, and input. These three policies are also in that Attachment A and they are listed here.
Policy 2A would allow greater numbers of smaller BMR units to be substituted for the more standard completely proportionate balance of units in a project. Presently we require that the BMR units be like the market rate units in the unit type and size. So this would allow other types of arrangements but it would require that more BMR units be provided if they are not proportional in size to the market rate units. We would develop specific formulas. Our consultants gave us some parameters to use in doing that.

Policy 2B is a way of securing land for affordable rental housing construction that our nonprofit housing developers would do. It would require as a default option on larger sites that land dedication would be required. If it weren’t feasible in a particular situation then we would revert to a standard BMR plan where the developer provides units in the project. It would alert the developers up front that that’s the City’s policy so that before they even begin designing their project they come and talk to us about the land dedication option.

Policy 2C is to base the number of BMR units required on the site’s size and existing zoning density. Then that would be set for the site so it would not vary as developers come in as they frequently do with project proposals that are below the zoned density of the site. Slight reductions could be made to accommodate the various zoning parameters of development controls for open space or things like that or setbacks or things like that to base it on realistic development potential for a site. This would act to reward developers that come in and build more housing on a piece of land and indirectly encourage developers to fully utilize our limited land resources for housing.

This slide just summarizes the actions that Staff is recommending the Commission to take tonight. To direct Staff to incorporate the policy proposals in Attachment A together with other BMR program policy into a draft ordinance for review and adoption by the Council, and to direct Staff to study the policies under Goal 2, Policies 2A through C as part of the next Housing Element revision, and direct the City Attorney’s Office to prepare revised ownership deed restrictions and related enforcement and disclosure documents for use upon the effective date of the ordinance.

We are just in really the early stages of public review and discussion. The next steps would be a City Council review of the changes hopefully in November, then the drafting of the ordinance and related changes to the Housing Element text, and then we go back to the Planning Commission again for your review and City Council review and adoption, hopefully by early in the new year. Then there are the legal documents to complete and then at that point we would be ready to incorporate the changes.

So now we can take questions and proceed.

Chair Holman: Commissioners, are there clarifying questions at this time? Commissioner Sandas.

Commissioner Sandas: Is it Cathy? Okay, I have two questions for you. One is a clarifying question having to do with homeowner association dues. If someone buys a Below Market Rate
unit in a condominium complex how are their homeowner association dues assessed? Are they assessed at a different level or is it the same as all the rest of the homeowners?

Ms. Siegel: Well, I am not an expert on this but condominium associations are regulated by the state and the developer has to submit budgets and proposals for the operating costs of the condominium association. Through that process somehow the state approve the initial amounts of the monthly dues. We had an attorney look into this in connection with 800 High because the BMR units there were significantly smaller than the market rate units in size. So we wanted to be sure that any costs that are covered by the monthly dues were proportionate to the size of the BMR units as much as legally possible. So that did happen and the monthly dues there for the BMR units are about $100 less for a two bedroom BMR unit versus a two bedroom market unit. So it helped somewhat but we were only able to do that because the BMR units were substantially smaller. For the developments such as Arbor Real and the Hyatt Rickey’s site where they are exactly like other market rate units the dues will be exactly the same.

Commissioner Sandas: So in other words if someone were to get into a BMR unit and based on the cost of the unit their monthly mortgage payment is $300 a month that is tax deductible they could potentially have homeowner’s association fees that are higher than their monthly mortgage. Is that your point?

Ms. Siegel: No that only happens as people pay off their mortgage. Most BMR owners are purchasing units with a significant mortgage. They don’t usually have lots and lots of money for a down payment. When we price the new units the new units are going to be built each year we calculate an affordable price and we wrap in an average amount of homeowner’s dues and an allowance for insurance and property taxes and maintenance and things like that. So that is all wrapped into what determines the initial affordable price.

It is just that over time what has happened is units that people bought 25 years ago their homeowner’s dues might have been $50.00 a month or $75.00 a month and now they are $350 or $400. There are a lot of things behind that. There are much higher requirements on these associations for reserves for liability insurance, maintenance goes up, and everything like that.

Commissioner Sandas: I have one last question that is relative to in talking about the CPI you had mentioned that some BMR owners might be able to sell the unit they are in and upgrade to a slightly larger BMR unit and you mentioned something about people’s incomes. I just wonder are BMR owners incomes periodically checked or is it just once you are in you are in?

Ms. Siegel: No, in BMR rental housing and other types of low-income housing the tenants have annual income checks and certifications that they have to go through. Eventually if their income gets over a certain amount they have to move out or their rent goes up, it depends.

For ownership housing you really can’t do that type of thing. People’s incomes are very thoroughly checked when they apply to buy a specific unit. Their assets are verified, they have to submit copies of tax returns, all they income and assets are documented, their household composition, and it is quite extensive. But once they actually become the owner then they can own it as long as they want to even if their income does go up.
Commissioner Sandas: Thank you.

Chair Holman: I would like to make one comment about how we are going to proceed on this matter before we go to Commissioner Lippert and then Commissioner Keller. There are many, many questions that could come up regarding the BMR program and in order to have an orderly meeting what we are trying to do is address the items that are in the Staff Report and then if there are other things that Commissioners want to talk about during a study session or something of that nature Vice-Chair Garber will keep a list of those items but we want to keep focused on the Staff Report issues that are in front of us. Commissioner Lippert. Yes, Commissioner Burt.

Commissioner Burt: So is it then the intention then that there would be a study session of the Commission on additional items related to the BMR program?

Chair Holman: If the Commission so desires Staff is certainly open to that. There were a number of issues – do you want to speak to that, Julie?

Ms. Caporgno: When we talked at pre-Commission yesterday we suggested it so that we could get through these items today. We know that we haven’t brought the BMR program to the Commission for a long time and there may be just questions you have about how the process works, etc. So if you had those types of questions if you could save them we would be glad to come back and have a study session. If it is something that relates to the changes, even the ones we aren’t focusing on, we would like that information tonight because we are going to be taking these recommendations back to the full Council. The recommendations from the study will be coming back to as Cathy mentioned but once they go to Council it will be focused then to changes that are within the Comprehensive Plan and then the ordinance itself.

Commissioner Burt: So then questions related to a general understanding of the BMR program, background understanding, by Commissioners would be prospectively in a study session. Otherwise this is our only crack at making recommendations to the Council on specific changes to the BMR program, is that correct?

Ms. Caporgno: That is correct.

Commissioner Burt: So any changes that we think are appropriate tonight we should go forward and make those as changes.

Ms. Caporgno: I think we would appreciate if you could focus on kind of the parameters of the study. If there are other things that you think that the BMR program could consider that we could do when we look at the BMR program in the Housing Element as these three items that were identified, do you think that they are worthy of consideration? We are not asking you to make a recommendation on yes or no but just whether or not we should even explore them in the Housing Element. So you will have an opportunity to come forward with those types of things and that may be worthwhile in a study session. If you could just focus on kind of the parameters of the study itself because that is really what we want to take to Council.
Commissioner Burt: When you are referring to the study are you referring to the KMA/AA Report?

Ms. Caporgno: Yes.

Commissioner Burt: The report we didn’t receive?

Ms. Caporgno: My understanding was that you received that. It was supposed to have been sent to you in a disc sometime ago.

Chair Holman: I think the Commissioners did not relate one to the other.

Commissioner Burt: Evidently sometime ago when it went to Policy and Services it was apparently sent to us in a disc form and then there has been no reference to that as this came to us. So apparently Commissioners were not aware that that was a basis for this hearing.

Chair Holman: Just one clarification too, what I had understood at our pre-Commission meeting was what you said in the latter portion of your comments that if there are additional comments or recommendations we have about the BMR program we can make those, this isn’t our only crack at doing that. Maybe you want to clarify that, Julie.

Ms. Caporgno: I think the recommendations that Staff has are based on the study that went to Policy and Services and they supported various recommendations. Then obviously they had this one issue regarding the retroactive issue and then the three recommendations for further study. Really, within that realm if there is anything that you want the full Council to consider now is the time to raise those issues. As far as a full crack, there are certain things in the study itself that we didn’t send to Council that we didn’t focus on. There is an opportunity for the Commission in a study session to raise those and we can also address those when we come back as far as the Housing Element review.

Chair Holman: Okay. Commissioner Lippert.

Commissioner Lippert: With regard to the proposed Policy 2A and proposed Policy 2C is there any benefit looking at BMR being based on percentage of floor area rather than units with a minimum unit size?

Ms. Siegel: I think that is the kind of idea that we would want to study further in terms of just looking at the concept. Presently we do kind of crosscheck with floor area because units are so large. So the basic requirement is 15 percent we look at the developer needs to provide 15 percent of the units. Often there will be a few premium units that we won’t pick for BMR units and so we kind of adjust and there is always rounding because the 15 percent hardly ever works out exact. So we round to make it work and we crosscheck on the floor area to make sure we are generally getting about 15 percent of the floor area now.

Commissioner Lippert: So if I understand your answer there might be some advantages to looking at FAR versus....
Ms. Siegel: Yes, especially if you have a project with a lot of really big units.

Commissioner Lippert: Okay, then follow up on that. When we reviewed Alma Plaza it had been mentioned to us from the Housing Corp. that it was more desirable to have rental units versus for sale units as BMR units. Maybe this is a question that would go into a study session because there may not be an appropriate answer at this time. Would it be appropriate that say those condominium units would be held in ownership by the Housing Corporation and rented out as rental BMR units?

Ms. Siegel: Well the consultants, Keyser Marston, did look at that idea in the study, which I really apologize if you didn’t get copies of the study. I thought they went out at the time they went out to Policy and Services.

Commissioner Lippert: They did go out.

Ms. Siegel: Okay. They did look at that and they found it had some problems. One of the most serious problems is that in an ownership project we are able to allow the developer to sell the BMR units at prices that are much too high for anybody that would operate them as rental housing to pay that money. Say you have a three-bedroom BMR unit you can sell it now a days for $325,000 or something like that. You can’t buy that BMR unit and be paying the taxes and the monthly homeowner’s dues on it and rent it at a very low-income rent. There is a big gap there. You have to have another subsidy on top of it. So we would either have to take a lot fewer units or come up with some other source of money to make that kind of thing work. Then I think there would also be some issues with rental units in an ownership condominium that also would have to be explored that could be a real problem.

Commissioner Lippert: I think this would be a topic for that study session but my thought on it just briefly is that this also would allow for the Housing Corporation to sell those units and then put those monies into other units.

Ms. Siegel: Well, if we want money we can accept in lieu fees directly from the developer, which is pretty simple. One of the recommendations in the study is that we have a thorough analysis of our in lieu fee formula to make it more accurately represent the benefit to the developer so that the developer is paying the same amount by paying fees as they are by providing us units. Right now there is kind of a gap there. It is a little easier on the developer to pay fees.

Chair Holman: Commissioner Keller is next but I am seeing as we are asking questions heads nodding and shaking. So what I am thinking, so if you want to nod your heads and shake them, it would seem like as we ask our questions it might give members of the public an opportunity to maybe help edit or add to your comments. So if that is helpful to you all I think we will continue with our questions and you might be able to give better feedback to us as we go forward. I am seeing an affirmative there. We usually go to members of the public a little earlier than I think we might do tonight. Commissioner Keller.
Commissioner Keller: Thank you. In follow up to Commissioner Sandas’ question the
homeowner’s association dues and assessments come both from BMR unit owners and other
condo owners, is that correct? So if there were some accommodations for BMR unit owners
how would that affect the other condo owners? How would that be handled?

Ms. Siegel: Well, they would have to pay more. There is a given budget each year for the condo
association to pay its expenses and keep the project up. The BMR owners are at least probably
ten percent in every project. Some projects had particular agreements where there would be
maybe 20 percent BMR owners. So it depends on what share of the units are BMR but it would
definitely have a large impact on the cost to the market rate owners.

Commissioner Keller: I know you said that you weren’t an expert in homeowner association
dues but you did mention that there was some accommodation for 800 High because of the unit
size. Would you expect that accommodation would also occur for unit sizes for market rate
condos that there would be similar accommodations and it is basically those principles that you
are applying here?

Ms. Siegel: Well, what seems to be done now is that dues for market rate owners do relate to the
size of their unit. So if you have smaller market rate unit you pay less per month than somebody
with a big four-bedroom luxury penthouse. There are older projects where everybody pays the
same every month. I guess that was maybe under earlier systems that the state had. Like I said,
it is a state department that regulates this type of thing.

Commissioner Keller: I assume it is the homeowner’s association itself that sets the homeowner
association dues that the City has no involvement in that, is that correct?

Ms. Siegel: Correct, the City has absolutely no involvement. Just because there are BMR units
doesn’t mean we have any voting representation on the homeowner’s association. So once the
initial dues are set which is a matter the developer and the state agency setup then once they sell
all the units then they elect their Board of Directors and they are responsible for their budgets
and their dues.

Commissioner Keller: Thank you. Follow up to Commissioner Lippert’s questions there is
interaction between Policy 2A and 2C as he talked about. I am wondering if you look at the case
that he brought up in terms of Alma Plaza there is a difference between the Alma Plaza units that
are BMR units that are rentals and that has in some sense different economics to for sale units I
assume. I would also wonder whether differences in amenities would be taken into account.
Whether for example private garages or two car garages versus one car garages versus non-
dedicated parking space or carports or whatever that differences in that might be taken into
account in addition to just square footage as part of the calculations. Is that the kind of thing that
you were looking for in terms of 2A?

Ms. Siegel: Yes, we would definitely take all of those things into account. The implementation
of 2A while we could have some type of a formula to convert ten three-bedroom units into X
number of one bedroom units there would also always be a lot of negotiation involved on the
specifics of it.
As far as how we do things right now we have a one page policy document on standards for BMR units and it talks about how they have to have the same amenities as the market rate units, the same type of parking and recreation facility access distributed throughout the project. Things like that.

Commissioner Keller: If you were to impose the Policy 2C on let's say an RM-30 zoned property and the developer were developing the rest of the property as 17 units per acre as for example happened on the East Meadow Circle developments, those are approximately 17 units per acre I believe. Then what you were talking about would be more smaller units at the effective density of 30 units per acre and so there wouldn't be 15 percent there would be 15 percent if you will of what it would be at 30 units per acre. Is that what you are thinking about?

Ms. Siegel: Well, not necessarily. You could combine the two approaches but what 2C was looking at is you could even map it or something like that where you would have a piece of land and say it is RM-30 so it is three acres and roughly it could hold 90 units maybe minus a bit for different other requirements that apply. Then you apply your 15 percent BMR requirement to that and that mathematically just gives you the number of BMR units required. So if the developer goes out and chooses to build their 17 unit per acre townhouse development they have more BMR units that they have to provide in those townhouses they build. So it doesn't have to relate to 2A.

Chair Holman: Okay, passing it along. Commissioner Tuma.

Commissioner Tuma: I have a couple of questions on the retroactive application on the change to full CPI and I will start with the legal questions. This is directed to the City Attorney, if you could expand a little bit on the concerns about legal challenges from past owners. Are we concerned simply that we are going to get sued or are we concerned that there is actually viable claim?

Ms. Melissa Tronquet, Deputy City Attorney: We are not particularly concerned about claims from past owners. Certainly they could make a claim. Our concern about applying this retroactively is the concept of gifts of public funds. The California Constitution prohibits gifts of public funds. Generally what that means is that we can't give public monies where there is no public purpose. Typically gifts of public funds to individuals have been suspect. So in this case to the extent that we are talking about going back and compensating people who have already sold their BMR units that would likely be a gift of public funds that would be prohibited because these people bought, owned, and sold under the assumption that they were gifts under the one-third CPI formula. Question?

Commissioner Tuma: Yes, I am confused. It says here that we are concerned about the legal challenges from past owners. Are we aren't we? That is the first question.

Ms. Tronquet: Legally we are not I think perhaps we are concerned that people could raise general fairness claims but essentially our defense to such a claim is it would be a prohibited gift of public funds to those owners who have already sold.
We are still analyzing the issue of applying it retroactively to current owners who would sell later. Certainly you could change the program going forward you have done that before but to the extent we are applying the new formula to past ownership that is where the question of gift of public funds comes in.

**Commissioner Tuma:** I am a trained, practicing attorney and I am still not following this and I apologize for that. I am not a big fan of running because we are afraid we are going to get sued. If we are afraid we are going to get sued because there is a viable claim and that we may be doing something wrong then we shouldn’t do that but just because we might get sued to me that is not a reason to run. The gift of public funds issue maybe I am just not getting it here I wouldn’t advocate that we go back and give people who had already sold their units but from a legal standpoint why wouldn’t we consider applying this retroactively to people who do still own their units and then those people sell them later that would be fine?

**Ms. Tronquet:** That is the little piece of the gift of public funds concept that we are still analyzing. These people bought and currently do own the units with the deed restriction that says they have the one-third CPI formula. So it is questionable when you do the gift of public funds analysis that we haven’t completed yet whether going back in time and giving them an increased formula for the time where they owned it with the expectation that they only had the one-third formula giving them the difference between that is questionable. So we should have an answer to that by the time this goes to Council but we are still looking at it right now.

**Commissioner Tuma:** Okay. Why are those public funds? By adjusting that to a full one percent of one-third that wouldn’t that simply be a function of what someone in the market would pay? Why are those giving up public funds, City funds? I don’t understand.

**Ms. Tronquet:** That is something we will take into our analysis certainly. Cathy talked about the concept of windfall and things like that. It is something we will take into our analysis we just haven’t completed it.

**Mr. Williams:** If I could just add I think the difference here is there is a certain contractual expectation they have as far as appreciation and potential. If we go back and essentially in that period of time the City is increasing that without a contractual obligation to do so that there is an argument to be made at least that the City is contributing public monies to that individual and that’s not appropriate or necessary for the City to do it. Whereas starting now if that is our rule and that is what the contract says is 100 percent of CPI then we are contractually obligated to do that. So it is an argument and we are not sure where that is going to fall but it clouds the issue of trying to do something retroactively.

**Commissioner Tuma:** If you would indulge me just one more because I don’t want to lose the train of thought here. Because another issues that further comes down is provide a windfall with no relationship to the condition of the unit. Could we, if we made these retroactive, also in order for them to get that require that the units be in a certain condition? Part of the entire concept here is to upgrade the quality of the stock going forward. If we can get that retroactively wouldn’t it make sense to potentially apply that, condition on the units being of a certain grade as
we would going forward in order to bridge that inequity of giving them something for nothing and also at the same time accomplishing one of the goals of bringing the units up to snuff.

Ms. Tronquet: I think that is exactly the kind of comment you are looking for or the Planning Department is looking for.

Ms. Caporgno: What we were trying to do with the recommendation of giving them kind of a lump sum if they in fact did bring it up so that it was saleable and in good shape. That was kind of what we were trying to accomplish. Across the board there wouldn't be this fluctuation of some units depending upon what they were originally sold for having more of an increase than some that were lower priced originally but maybe the upgrades had been comparable.

Chair Holman: Commissioner Sandas has a specific follow up.

Commissioner Sandas: Just a quick follow up. Curtis, what you had said just so that I understand clearly is that basically when people between 1984 and now purchased a BMR unit and they knew that they would appreciate at a value of one-third CPI they were satisfied with that. So if we retroactively changed that then in fact that is where the windfall or the gift of public funds comes in. Did I get that right?

Mr. Williams: I think so, and they can correct me if I misstate this. It is a contract, it is a deed, there are restrictions that lay that out and they sign it and they are agreeable to those terms when they enter into the agreement to buy the unit.

Chair Holman: Commissioner Keller has another direct follow up and then Commissioner Burt.

Commissioner Keller: It seems to me that based on what Commissioner Tuma suggested which is that the bonus increase is conditioned on the unit being in good repair would that differentially reward people who are long term owners to put their units in good repair as opposed to somebody who bought a rundown unit three years ago who would not have the same kind of incentive to fix up his or her unit when they sold it?

Ms. Siegel: Yes, I think you could make the case that that's not really structuring the incentive correctly if you have owned it a long time then you get this retroactive appreciation and that is a larger sum of money. We do have units out there that somebody just bought maybe a year or two ago and they weren't in the best condition when they bought them.

Commissioner Keller: So would it be better to do some sort of incentive directly tied to the amount of investment that was made in improving the unit as opposed to the longevity of the tenure of the ownership?

Ms. Siegel: That is why we came up with an idea of just picking a flat rate sum that would compensate an owner more than the typical cost of doing basic interior renovations so they could cover the cost of the renovations and they would get this bonus. It wasn't related to how long they had owned the unit.
Chair Holman: Commissioner Burt.

Commissioner Burt: I now have one follow up to that string of questions that we have had. Commissioner Tuma has opened a can of worms I guess. The Staff Report seems to be making a suggestion or recommendation to the Commission at least partially based upon the notion that there might be a legal problem. Then the recommendation that the Staff Report is doing is based on a ‘might.’ So this is our crack at making recommendations to Council and given what we have heard from the City Attorney that no greater clarity that this is a likelihood of a legal problem should we make our recommendations tonight as if there is no legal problem? Then if the City Attorney’s Office by the time it goes to Council has determined that they believe there is a legal problem then that would probably supersede any recommendations the Commission would make if they were ones that would be rendered moot by that legal determination.

Ms. Caporgno: I would recommend that you do that and you also have maybe a backup recommendation so if is superseded then whatever your recommendation is that also goes forward to the Council so they are aware of what your second recommendation would be.

Commissioner Burt: Okay. Another clarifying question on page 4 of the Staff Report to us the fifth line down says, “An owner that sold in recent years and received the one-third CPI appreciation might challenge a City policy that gave their neighbor BMR owner a sales price that was three times higher.” Isn’t not that the sales price would be three times higher but the appreciation price would be three times higher?

Ms. Siegel: Yes, that is a good correction.

Commissioner Burt: So that could be a big difference so let’s make sure that is clear.

On the next page, page 5, there are four bullets. I was struggling to understand it until I compared it to Attachment A and the oral Staff Report tonight. It appears to me that perhaps the fourth bullet should have been an overriding statement not one of four bullets. The following three bullets, Policy 2a, 2b, and 2c should follow under that statement because it says in there that the Planning and Transportation Commission provide input to the Council regarding the viability of the following three policies for further review. I think they are the above three polices. So should that be a paragraph not a bullet and placed up above?

Ms. Caporgno: That is correct.

Commissioner Burt: Okay, good. Now the substantive thing I wanted to ask about. It gets a little complicated and I want to put it in as simple terms as I can. When we set BMR rates they are based upon a certain percentage of median county income, is that correct?

Ms. Siegel: Yes.

Commissioner Burt: Okay. So then if we have over a period of ten or 20 years the appreciation is only at one-third of the Consumer Price Index and I don’t know if Staff knows the answer to
this but I believe the rise in median county income in Santa Clara County has exceeded the
Consumer Price Index. Is that correct?

Ms. Siegel: Yes that is correct except for the last five years when HUD has kept the median
income exactly the same.

Commissioner Burt: Okay. So it has either been at a rate that is exceeding the CPI or at the rate
of the CPI.

Ms. Siegel: Well, the HUD median income can also drop. In general over the long term the
median income in the county has gone up at a higher rate than the CPI.

Commissioner Burt: Okay. So even if it were only going up at that rate of the CPI but in fact we
have a history that has gone up faster doesn’t that mean then that these units don’t maintain their
original relationship to the median county income that they had when they were sold initially?
They are actually dropping down the ladder in terms of affordability and the relation to the
median county income. They are not staying at the same level of BMR availability they are
going from affordable to very affordable or some categorization because we are going at one-
third of the CPI and if it just stayed at the CPI it would still perhaps be getting then sold at a rate
that is a lower relationship to the median county income than when they were first bought. Is
that accurate?

Commissioner Burt: That is correct. From reviewing old Staff Reports and minutes from when
the program was initiated it seems that that was one of the goals in the way it was structured and
why they expressly did use an index such as the CPI. When they changed to the one-third CPI
there were comments about it being a good thing that the units became more affordable gradually
over time. There are a lot of different ways to run programs like this and many communities do
choose to price the resale units the same way they price brand new units. That has its upsides
and downsides. You are serving always buyers in the approximate same income brackets. You
can have some real issues with short-term fluctuations in interest rates and things like taxes and
homeowner’s dues and other components. State redevelopment law requires you price units on
resale that way, the same way you price the new units.

Commissioner Burt: I am sorry could you repeat that last part and explain that?

Ms. Siegel: State redevelopment law, a lot of affordable ownership program units are produced
under redevelopment programs not under programs like our inclusionary housing program. State
law dictates how communities administer certain aspects of those programs. The law does
require that they price the resale units in the same way that we price our new units so they are
always serving the same income bracket. If your interest rates have shot up, say somebody owns
a home five years and then has to sell and the interest rates are two or three percent higher, then
if your median income hasn’t gone up correspondingly you can have your seller having to take a
loss to get that unit sold because it has to be sold at a lower price. I don’t know how carefully
they all thought this out 30 years ago because our program was a pioneering program in the state,
probably the first. It did seem clear in looking at the old records that they did want the units to
become more affordable over time. It does have the good benefit that we still find buyers that
are a little bit lower in income than the ones that can afford the new units but they are still perfectly good homebuyers and can afford our less pricey existing units.

**Commissioner Burt:** Well, a follow up to that formula that you were describing. If we have an interest rate increase is the eligibility for acquiring these units based upon the monthly payment that would be made against principal and interest or principal?

**Ms. Siegel:** This does get a little complicated. I don’t know if this might be something that really should be covered in a study session about how we calculate prices.

**Commissioner Burt:** I think I can handle it.

**Ms. Siegel:** Okay. We develop prices once a year and we give that information to developers and use it in negotiating agreements with developers who are building us new BMR units. We take the median income and we have two price categories now with the latest Housing Element the bulk of the units are at the lower end of moderate so they are priced based on people at 90 percent of the area median income adjusted by household size for different unit sizes. Then we back into a price based on what a theoretical household at that income can afford spending 30 percent of their monthly income for housing costs including taxes, estimated homeowner’s dues, insurance, maintenance, and a mortgage payment at an average rate that we are getting at that time from the lenders in our program based on a five percent down mortgage.

**Commissioner Burt:** So the simple answer though to my question would be whether when we look at eligibility and you had said previously that we would risk rendering certain potential buyers ineligible or unable to buy because of a potential increase in interest rate. Then my question was when we look at eligibility for different programs is it based upon principal and interest or principal only. It sounds like it is based on principal and interest.

**Ms. Siegel:** When we are studying prices to use with the developers we are including interest and principal on a 30 year fixed rate loan assuming it is 95 percent loan to value. When actual real people from the BMR waiting list want to buy a unit they are given the price of the unit. They have to go out there and find financing. At that time it could be that the interest rates are somewhat different than what we used when we set that price back when we negotiated with the developer. They might be a little higher. That person has 20 percent down payment not five percent. They might have 50 percent down payment. So what is affordable to that particular household is a different situation than just sort of this hypothetical scenario we use to set prices initially.

If it is a resale unit then that price was set with the developer maybe ten or 15 years ago and now it has been appreciating along with this one-third CPI formula. So over the long run it has gotten more affordable.

**Commissioner Burt:** Thank you.

**Chair Holman:** I want to interject one question here. I asked members of the public if they were agreeable to speaking later after hearing a lot of our questions. I also want to make sure no one
has to leave. So is everybody okay so far? Okay. Commissioners, if it is okay with you I just
want to make sure everybody gets an opportunity to speak. So members of the public do you
want to go ahead and speak or do you want to wait? Why don’t we start public comment then?
Are you having to leave, ma’am? If no one has to leave specifically then I will just take the
cards in the order that I have them, which means the first speaker would be Kate Mills. Is Kate
Mills not here? Greg Kerber is our second speaker and Greg will be followed by Mary Ryan.
We will come back to Kate Mills if she comes back. Three minutes for each speaker and then if
you need more we will be lenient or ask you questions.

Mr. Greg Kerber, Palo Alto: Okay, thank you. I am not sure where to begin here because there
have been so many things brought up. I just want to address a couple of things. The difference
between the recommendations that were made at the time the Policy and Services Committee
met and the recommendations that were made tonight at least with regard to the retroactivity
concerning appreciation are much expanded. In the original the only comment that was made by
the City Staff with regard to retroactivity was this on page 6. Staff does not recommend
applying the new formula retroactively because it would be unfair to those owners who sold
before the change became effective. That’s it. So I raised the question at that time, I said look if
you are concerned about fairness, I am concerned about fairness too. I am not unconcerned
about being fair to people but why would you be so concerned about fairness to the people who
are already out of the program as opposed to those people who are still in the program and would
be able to benefit from an fair increase in appreciation? Nobody is asking for an exorbitant
increase in appreciation just for a fair increase in appreciation. One of the things you need to
keep in mind too is this, I didn’t know this at the time but then I followed up with a public
records request with the Planning Department, units that were sold between 1973 and 1983 that
are still owned by people who bought them then, I don’t know how many units that is because it
is a little bit vague in the report, all those units were initially appreciated at a rate of 100 percent
of CPI. That is according to the information I got from the Planning Department. The change
was made in 1983 to reduce it to one-third of CPI. They never changed it back. Somebody
should have noticed in 1986 that what they saw as double-digit inflation was no longer double-
digit inflation. So for a period of almost 20 years nothing was done it was kept at one-third of
CPI but you have people still in the program apparently who are still getting 100 percent of CPI
as opposed to one-third. I don’t know how people see that but to me that is not fair. Now La
Doris Cordell brought this issue up not me at the time this discussion was taking place at Policy
and Services. When this discussion took place she raised the issue with regard to discrimination.
She raised it when issues were brought up such as depreciation rate, segregation of units in the
different complexes, etc. So I am not going to put words in her mouth but she brought that issue
up and it was discussed.

I really don’t understand two concepts, the windfall profits if you will and there was one other
because I can tell you what my unit will go from depending on the appreciation rate. I bought a
unit in 1984 probably one of the cheapest units in the city at $35,000. It is currently worth
$44,600 that’s it. That is what my unit is worth. That is ridiculous even if you compare that to a
unit in my building that was a market rate unit that sold in 2004, identical to my unit, sold for
$375,000 that was originally priced at I believe around $100,000. If my unit was to sell today at
100 percent of CPI it would $59,500. Where is the windfall profit? That is not a windfall profit
that is just a fair appreciation rate. I could go on but unfortunately I have run out of time.
I would say one thing about the gift. I don’t see this as a gift. You are not giving public money to people. What you are doing is saying if you went back retroactively we are going to allow you to get 100 percent of CPI. The person who is buying your unit is going to pay for that appreciation not the City of Palo Alto.

Chair Holman: Thank you, Mr. Kerber. Mary Ryan to be followed by Marlene Prendergast.

Ms. Mary Ryan, Palo Alto: Hi, thank you. First of all I would like to thank the City for being committed to affordable housing in probably one of the least affordable places in the country and for being committed to making changes in that program.

I bought my unit in 1995 for two-thirds of the market price. I believe there is a subset of units within the program that paid two-thirds of that amount. I did the calculations based on the appreciation formula and found that if I sold it today I would get 38 percent of the market rate. So I paid 66.3 and I am entitled to 38 percent. My neighbor, Sylvia, she bought at one-third and her calculation says she is entitled to 11 percent. Maybe the thing that makes the most sense, which was mentioned, is to have a set price for particular units of particular size. Then go with reducing that amount for ones that are in disrepair and increasing that for ones that have had substantial capital improvements. I personally have replaced all of the major appliances in my unit. I have re-carpeted the entire place. I had put in ceramic tile in the kitchen and the hallway and I put in built-in bookcases in the bedrooms. These are major improvements but still I am looking at 38 percent when I paid 66.3. Thank you.

Chair Holman: Thank you very much Marlene Prendergast to be followed by Kay Wright.

Ms. Marlene Prendergast, Palo Alto: I am Executive Director of the Palo Alto Housing Corporation, 725 Alma Street.

I am hoping that you have a copy of a letter from the Housing Corporation that was sent to the Policy and Services Committee. It didn’t get into the packet but it did get – and just briefly to summarize a few main points from that on the general issues. I don’t know exactly how much all of you know about the knits and lice of the BMR program but the Housing Corporation basically administers the sales, keeps a waiting list of people who want to buy, and when someone wants to sell we process the next eligible person and make sure everything is all right. Then in the rental BMR units, which are not as numerous, we check the incomes or we make the manager check the incomes every year. So we assist in the administration of the BMR program. I also have worked with this whole concept since 1980 in Palo Alto primarily and in other communities as well.

I think what I would like to say is our BMR program is really very good. We are tinkering here with issues that are very, very important but inclusionary zoning which is the planning word for this is getting very, very popular in every community in the state pursuant to some state law encouragement is adopting this as sort of a new idea. We are at least happy that we have been doing this for 25 years and we are finding some things that aren’t in synch and that is really what is happening here.
We have recorded legal documents that need to be improved. We have ways we need to encourage better maintenance and renovation. We need to codify a little better our administrative policies, and we are producing homeowner workshops for financial education. So the one point of this letter is these sorts of administrative things need to be dealt with soon while we are still getting an influx of new units.

The big issue in the amount of the appreciation, this is big of course to the people involved, and we have been talking about that also for 35 years. It actually was true in the very beginning that when we had the units come on and it was 100 percent CPI they really went up fast. Now this is all relative to much cheaper prices and bread was a nickel and so forth. Now a days the higher, higher market rate can absorb more appreciation so we have been looking at this over time.

Chair Holman: Go ahead, we extended the other one.

Ms. Prendergast: The Housing Corporation Board was involved in the study and Cathy did certainly the most work on it but we have a BMR committee that considered it as it went along. We were wary of this 100 percent thing at first because in the early days we saw these units appreciate very fast in a period of high interest rates and all the rest and they were getting so that they no longer were affordable to the population we wanted to have own them. So we were very instrumental in getting the appreciation rate reduced to one-third.

It is sort of since the mid-1980s the restriction on equity appreciation of the CPI index has then had the unintended affect of producing BMR units with resale prices so affordable because the appreciation is so restricted that very low-income households are becoming income eligible to buy them. Again, that is not the population it was intended to serve, the low moderate income.

It is a long history and I guess I really just want to say that it does relate to economics and it isn’t like a lifetime decision these things have to become just rational policy decisions at a particular time when we see things happening that are not in synch. Yes it may appear to be fair or unfair to one population or another but it isn’t like it is a discriminatory effect. It is policy. These inclusionary zoning ordinances have a lot of goals and the Palo Alto goal has always been to maintain the affordability of these units so that they are basically permanently affordable to the intended population. So we have deed restrictions that go on for years and we have a limited appreciation which everybody pretty much understands when they buy.

Chair Holman: Marlene, I know there are at least six questions for you and you can either take questions now or we can listen to the rest of the public.

Ms. Prendergast: I am happy to take questions now if that works in your process.

Chair Holman: Okay. I know there was one lady who needed to leave fairly soon so maybe we will hit a couple of questions and come back. Okay, if you can stay then. Commissioner Keller you had a question, I think you were the first.
Commissioner Keller: Yes. I had asked Staff about the issue of the idea of PAHC being an agent for acquiring these units, fixing them up, and selling them. I understand from Staff’s comment that that would be something that the Palo Alto Housing Corporation would not be interested in, is that correct?

Ms. Prendergast: We are not interested in having title to these units. The whole idea is that these people have title to a home.

Commissioner Keller: I am referring to the short period of time from when a homeowner of one of the owners of one of the units sells it PAHC would acquire it, fix it up as necessary, and then sell it to a new homeowner of a BMR unit rather than over a long term.

Ms. Prendergast: We had that opportunity in one particular case and it got very involved with liability issues, isn’t that the usual thing? But us hiring contractors and doing the work it got to be so complicated that we really began to feel that the City and we should think of a better way to increase care and maintenance and give incentives. It isn’t just maintenance it is giving incentives for improvements beyond just the depreciated value of those.

Commissioner Keller: Thank you. The other question I have is if the values of older BMR units are to be in some sense reset in some way what is your feeling on whether the resetting of that value to a higher value whether the increase should or the extent to which the increase should accrue to the homeowner who is selling versus the extent to which the increase should accrue – am I using too complicated language? Basically, let’s suppose you have a unit that was expected based on the earlier numbers to sell for X and because of that became more affordable and now for some reason it may make sense to sell it for Y. Do you see the difference between X and Y going to the seller of the unit or is there an opportunity for that to be money that goes to PAHC for making new units available to new residents?

Ms. Prendergast: Affordable housing includes a lot of components the BMR program is one of them. Us building rental housing that we own and maintain is another. The Alma Plaza was a third idea of having us have some sort of semi-ownership and management. So I think this study was primarily dedicated to the for sale BMR units and it struck us even though we were nervous at first that increasing the appreciation from one-third to 100 percent can be absorbed at least right now without getting so close to market because market had gone here, that we wouldn’t be able to sell the units. At some point people say Palo Alto is terrific but I can go to Mountain View or somewhere and buy a market rate unit for just a little bit more. The lady that had the one that appreciated at two-thirds we had some trouble selling those units back in the late 1980s and early 1990s because they were like $40,000 away from market. A person could say I will borrow an extra $30,000 or $40,000 and have a market rate unit. There are restrictions and the appreciations are little. Did that?

Commissioner Keller: Thank you.

Chair Holman: Commissioner Sandas also has a question for you.
Commissioner Sandas: Marlene, would you remind me one more time of who we are trying to serve with the BMR program? You had alluded to we are not serving the population we want to serve.

Ms. Prendergast: In the olden days it was more the households at about 80 percent of the area median. That is now because of the construction costs, prices, and so forth going up the BMR can encompass from 80 to 120 percent of median all of which under state law is still considered affordable. There is a range of affordability. So the older units by definition because of the pricing are more affordable to a lower income than new units at up to $400,000 some of them now, obviously attract a different scale. It is a fairly broad scale.

Chair Holman: Vice-Chair Garber.

Vice-Chair Garber: Did I understand your comments that the Housing Corporation was instrumental in creating the one-third mark some 20-plus years ago?

Ms. Prendergast: Yes.

Vice-Chair Garber: The objective there, again if I am understanding correctly, was to keep the units when they come back on the market from becoming less affordable?

Ms. Prendergast: Yes.

Vice-Chair Garber: So if in the circumstance where we are looking at changing from one-third to 100 percent what happens to the potential affordability of those units when they go back on the market and is that an issue for the Housing Corporation or the BMR program in general?

Ms. Prendergast: You mean the 100 percent?

Vice-Chair Garber: Yes.

Ms. Prendergast: Well, as I say at first we were scared because we remember 1984 and all the rest but we now have market rate units up in the $1.0 million, $900,00, $800,000 range and between $200,000 and $800,000 there is some room there to appreciate. As I say I think a lot of this has to do with the economy and we can’t make forever policy based on today’s economy. We need to be kind of watching and saying this is happening now like we have done with this big study and said we can absorb more appreciation and still have them be affordable to the right population.

Vice-Chair Garber: Just to follow up and I apologize because I like Commissioner Burt didn’t recognize that the disc that we got was related to this evening’s conversation.

Ms. Prendergast: You wouldn’t really want to read that whole thing anyway. They summarized it beautifully.
Vice-Chair Garber: I am pleased to hear that. What was the reasoning or the data that was found about today's market that caused the recommendation of 100 percent to occur?

Ms. Prendergast: Well, it was a number of things and I think Cathy mentioned some of them. I think one was that the older units were becoming so affordable that they were serving a low-income population. In some cases that was fine if they were eligible and the affordability thing worked out. In others there was sort of not understanding the full responsibilities of homeownership such as insurance, homeowner's dues, and things. It isn't just your monthly payment and that's all. The other thing was as the market rate units became so kind of astronomical the BMR units were sort of an inappropriate good deal. In other words, they were so affordable, this is policy decision, but there is room in the gap to go up. The developer's prices are going up, the people we are getting on the list have incomes that are going up, they can afford the higher priced BMR units and it just seemed we hoped we wouldn't get into the same situation we got into in the 1980s. I don't know if that address it.

Chair Holman: Commissioner Tuma and then Commissioner Burt.

Commissioner Tuma: It seems like one of the reasons we are in this situation is maybe we haven't looked at this often enough.

Ms. Prendergast: Might be. We see these things coming slowly.

Commissioner Tuma: With economic trends sometimes it is not maybe the thing that is on the tip of the tongue or the most pressing issue. Do you think it makes sense to build into whatever we do here a periodic review of some of these issues, whether it is every five years or ten years? Something that requires us to look at it affirmatively instead of waiting until we get into a situation where we have these types of disparities or would that be too burdensome?

Ms. Prendergast: I guess I would defer to the City Staff on that but I think to look at it every few years is fine. To have this massive BMR study on all the issues took so long it just was so big. I think that is not a bad idea. Yes, we look at it and we also come back to where our policies should be. Some cities feel like wealth accumulation is a good goal for the BMR programs so they may allow a 40-year restriction and then it is yours or even less than that. We got the affordability out of it and it is all yours. Palo Alto from the beginning and believe it is still the policy is to try to keep these units in an affordable state for the right population. So you may be looking at what is the situation economically more often and heading it off would be a good idea.

Commissioner Tuma: I am not suggesting the scope of everything that has been looked at but these particular economic levers that are somewhat, well quite, unpredictable. It may just make sense to build in a review of those types of things to make sure we are achieving the goals that we are trying to achieve by maybe adjusting these things and not have it all of a sudden where we have a 24 year gap since this particular issue was looked at.

Chair Holman: Commissioner Burt.
Commissioner Burt: My first question is related to what Commissioner Tuma just brought up which isn’t it the case as I am looking back and trying to understand what happened here that basically when we established this one-third or made this correction to the one-third of the CPI formula in 1983 we were coming off of a decade of exceedingly high CPI inflation and we said we have to make a correction there. Then we went through a decade where it changed and it lowered but we weren’t confident that it was going to stay low. Then in the early 1990s we finally hit a period where we were pretty confident that we were going to keep CPI at a long term, for the foreseeable future long term, low rate. Is that essentially what has happened here? Then because we didn’t adjust it for those 24 years as the market realities on interest rates and inflation changed we never made an adjustment and that is why we now have a pretty radical adjustment that we are looking at doing?

Ms. Prendergast: I don’t know if I would call it radical but it is yes I think that is a simple way to put it. We are busy selling units and we are busy writing procedures manuals and we are busy. On a household-by-household basis we see things happening and we are not unaware but we have just kind of gone on with these are the rules and then it gradually becomes a little more apparent. I think the consultant was helpful in helping us absorb that.

Commissioner Burt: I was trying to understand what happened and how did we drift into something that maybe was different from what we intended when we made an adjustment 24 years ago.

Ms. Prendergast: We drifted.

Commissioner Burt: So then if that is the case, either way, I want to make sure I understand what was the original reason for having for sale units versus for rent units. It seems that right now we have created a circumstance where housing ownership isn’t really what this is about. We have created a circumstance if we stay with the current formula where it is simply that by owning they get a cheap rent. It is not that they are really getting anywhere near the things that accrue with ownership. Somebody who buys from one of these homes that must sell at this very low rate is going to buy into a very low monthly payment that is equivalent to or perhaps below a very low rental payment. We have lost sight of whatever reason there was to differentiate between rental units and for sale housing units in our BMR program. Weren’t they intended to serve different people?

Ms. Prendergast: Well, yes. Is that the question?

Commissioner Burt: It is leading to weren’t they intended to serve different people and are we no longer doing that to the degree we originally intended?

Ms. Prendergast: They have always been the ideal of homeownership and of course you have whatever down payment you made appreciating and leveraging I should say, and you are deducting as you can the costs tax-wise and so forth. So it isn’t quite...we have 600 people on our waiting lists and some of them are totally irrational about owning, owning, owning, when they probably would be happier long term not doing that. But it is something they believe wholeheartedly in and I don’t know that we caused that. We call it a first-time homebuyer, they
don't technically have to be a first-time homebuyer because there are situations where one BMR owner sells one and moves to a larger BMR unit. So they have owned already.

It is what people seem to want even when we explain the restriction on appreciation that they could be leaving a lot of money on the table and they could find something perhaps, because Palo Alto is unique in sense of cost.

Chair Holman: I have a question and maybe it is two questions and then if you are able to stay for a bit I have a feeling there might be more questions if that is agreeable to you if you are able to do that.

Ms. Prendergast: You mean come back later.

Chair Holman: I am going to ask you a couple of questions then if you can stay with us for awhile.

Ms. Prendergast: Okay.

Chair Holman: My two questions at the moment are the 600 people. Homeownership is the American dream and this isn’t the typical situation. There are 600 people on the waiting list so what range or what level are most of those people in? In other words, are they 90 percent of the median or what level are they in?

Ms. Prendergast: I am not sure I can actually answer that really correctly. I know that there has been a period of well, I guess affordable housing below market rate and sometimes people thought well that mean really low income and that’s not me. People were surprised and delighted to understand that this wasn’t rental housing that services people in the 30 percent or 40 or 50 percent of the area median this was 80 to 100 percent and they realized this is me. Now I am forgetting your question.

Chair Holman: If you knew offhand where the 600 people in that list fell.

Ms. Prendergast: So my point was when we saw these more expensive new units coming down the pipe Arbor Real and so forth we looked at our waiting list and said we need to get the word out that these are not cheap, cheap, cheap units anymore. We made some real outreach and got the waiting list with a broader range. So there are folks kind of at the very low income that have been waiting and waiting and waiting and they probably may never buy a unit that is new certainly, maybe a resale unit. Then we have incomes that are up at the 120 percent of median. I don’t know the waiting list exactly right now as to the range but it is much bigger than it used to be.

Chair Holman: The reason I asked is because it is the pricing out issue, what range of people, what percentage of the 600 might be pricing out if we did something like the 100 percent.

The other thing is because you said something earlier about planning now but you have to look at this long range and the previous inflation rates could come back. There is a lot of discussion
about we don’t know if we are going to be in a recession or if we are going to have double-digit interest rates. This may be a question for you or maybe a question for Staff as well later. So would there be some mix of this or what about putting a cap so let’s say it is 100 percent but not exceed X percent of market rate? Would something like that?

Ms. Prendergast: Cathy I think you have something on that in the Staff Report.

Chair Holman: And if that is legal.

Ms. Siegel: Well, we did propose that there be a cap with the change to the full CPI to help it work in the long term when we can’t really anticipate what is going to happen with inflation and interest that the price of a unit being resold could not exceed the maximum price at 120 percent of the AMI based on then current interest rates and things like that. So it might become a lot less affordable but hopefully we would still be able to find a moderate-income buyer that could handle that price.

Chair Holman: Okay. Last question I think for Marlene that I have is the price of the unit is one thing but then there are the homeowner association dues and there are potentially parcel taxes and that sort of thing. So is there some gap that needs to be accounted for so there is again the sale price but then these other things have to be accounted for in terms of someone being able to qualify.

Ms. Prendergast: Well we do account for those in a matrix we show to a buyer and try to impress the other costs that are involved with a five percent down payment and all the other costs this is what your monthly obligation will likely be with a ten percent down payment and this interest rate. Now we don’t give a three-hour lecture about how the interest rates can change but this is sort of the hypothetical thing that Cathy mentioned. I don’t know if this is exactly your question or not but it is trying to impress that fact on people to show them what the real costs are.

Chair Holman: Okay, thank you very much.

Ms. Prendergast: Basically I want to reiterate that the Housing Corporation is basically with Staff on the recommendations and we don’t see any discriminatory problem legal or otherwise with – we think that the way it is planned right now is not discriminatory and should not be retroactive and we basically discussed that this morning at the Board meeting. Mr. Kerber is right it didn’t really come up until it was raised at the Council so we hadn’t focused on that particularly.

Chair Holman: Okay, thank you very much. Excuse me, I think there is one last question for you and then we have members of the public to finish. Commissioner Keller, clarifier.

Commissioner Keller: You said something in passing and I just want to make sure I got that right. I believe you said that the Board of the Palo Alto Housing Corporation did not recommend a retroactive increase to CPI but recommended a change to CPI from here forward.
Ms. Prendergast: Yes, that is correct. Also that the idea of the bonus and the incentive for more renovation we thought was a good idea.

Chair Holman: Commissioner Burt and then we are going to go to Kay Wright.

Commissioner Burt: I'm sorry, Marlene I thought from the comments that you had said leading up that you were supportive of the retroactive approach. So can you explain why the Housing Corp. is opposed to the retroactivity?

Ms. Prendergast: I don't want to be the one who talks to the people who had big assessments at Abitare, this is probably not a good enough reason, and who eventually sold their units and left town pretty upset. Their whole thrust at the time was we need more appreciation so we can borrow against equity to pay assessments and the City was unable to quite do anything about that to then hear that we now allow 100 percent which is what they spent three years advocating for. I also believe though that for taking existing owners and getting them to get the new deed restrictions recorded on their unit in return for getting the 100 percent takes care of existing owners, as I understand the plan. So there isn't a real retroactive issue except the unfairness to the folks who sold three years ago.

Chair Holman: One quick question by Commissioner Sandas and then we must get to the public.

Commissioner Sandas: Commissioner Burt I want to include you in this too. I think that we have a little bit of confusion about retroactivity. I think Marlene what you are saying people who have already sold we don't want to retroactively go back and compensate them in some way but people who have bought since 1984 who are still homeowners that changing their deed to say 100 percent....

Ms. Prendergast: If they will accept new deed restrictions.

Commissioner Sandas: Accept new deed restrictions that they would get the 100 percent CPI.

Ms. Prendergast: Yes, you are right, thank you for clarifying that. I also don't blame those former owners for being real mad.

Commissioner Burt: That definitely clarifies.

Chair Holman: Okay. Kay Wright to be followed by Cathy Taylor.

Ms. Kay Wright, Palo Alto: Hi. I want to put a human face on the BMR program. My name is Kay Wright, I am 60 years old and I have lived in Palo Alto for 38 years. I am a retired Master's level social worker who devoted 38 years of professional work to care and protect the children of this area. The past 20 years before I retired I was a Children's Protective Services worker for the children and families of Santa Clara County including the children of Palo Alto.

When I first heard of this program I was so happy to know that I could buy a home in Palo Alto. As I am sure you know social workers are not rewarded greatly for the work that they do. I was
on the waiting list for eight years while I lived in substandard housing in Palo Alto in order to
maintain the residency requirement to stay on the waiting list. Twenty years ago I bought by
condo for $100,000. I understand it is now worth between $120,000 and $140,000 if I would sell
it. My original deed restriction stated I could sell at one-third of the CPI from the time I bought
my home. I could let my child inherit my home. The term of affordability was 59 years. In the
past few years I have become rather disillusioned, let me say very disillusioned, and I have come
to feel that instead of owning my home I am essentially renting it until such time as the City gets
to bring it back to their BMR program without offering me fair value for the money I have put
into my house. A rough estimate of what I spent on my house over the 20 years is $250,000 to
$300,000.

A few years back I received a newsletter from Palo Alto Housing Corporation, the first and last
newsletter ever I might add, stating that the City Attorney had determined that BMR units could
only be inherited by owner’s children if the children also met the BMR regulations. I have also
read in the report today that the affordability term is recommended to be changed to 89 years in
order to keep all the BMR housing within the City.

I am now concerned that if I sign a new deed restriction that in exchange for a higher
appreciation amount I will lose the inheritability factor and increase the term of affordability.
My intent all along and what this City promised when I bought this house has been to give my
daughter a family home and to allow her to inherit it upon my death. I am sure all of you would
feel the same about that for your children.

I have no intent of giving up the rights that I have now even if I sell under the new guidelines I
will not be able to buy another condo in Palo Alto or anywhere in the Bay Area. For that matter
I couldn’t buy anything in the central valley or even in my hometown of Tucson, Arizona, which
as you know is very affordable.

In closing, I want to say and this is very sincerely thank you to the City for allowing me to buy
my home. My request is to continue to be able to live here, to have my child inherit my home,
and to be treated fairly by the City of Palo Alto. Thank you.

Chair Holman: I have a question for you ma’am. You said what you put into your place was
$250,000 to $300,000, that is in terms of payments, improvements, combination?

Ms. Wright: I have not had the money for improvements especially now that I am retired. That
is in terms of my house payment, my taxes, and my homeowners, which by the way has been up
to $445.00 a month. It has now gone down to $442.00 a month. So that is what I am including
in that. That doesn’t include naturally utilities and insurance and all of those things but that is
the amount that I came up with.

Chair Holman: Thank you very much, appreciate that. The next speaker is Cathy Taylor to be
followed by Jean Nolan.

Ms. Cathy Taylor, Palo Alto: This has been a very humbling experience. I have also lived at
The Rosewalk where Kay lives since its inception about 19.5 years ago. I teach and my husband
teaches preschool and probably has taught many of those who are living in multi-million dollar homes now. We only had a dream to have our children be able to go to school in Palo Alto and have a decent life too.

I think that the arrogance I have heard tonight on the part of the Housing Corporation astounds me. I think there are a lot of misconceptions about what it is to be a BMR homeowner. We have to be able to come up with not five percent but the bank at the time that we bought wouldn’t accept any less than ten percent. Some paid up to 20 percent because of your income to be able to get a decent interest rate. So our monthly fee was less and at that time it also less than what apartments were here because they had skyrocketed at that time because people couldn’t buy so there was that counter side. So we bought our place. The homeowner’s fees are identical to what everybody else pays. I have been on the homeowner’s association Board for the last 19 years, no, I am sorry 15 years. I have been very involved in making sure that the property is maintained and kept up to par so that those neighbors who sell their homes for $800,000 for the $100,000 that we paid are able to protect their interests. I felt that I have always held my weight. We don’t have the amenities that other units have on the interior but that is okay. We live very nicely. We take good care of our property and we care about it a lot. We might not have been able to put in very plush things but we keep it very nice. We were given very inferior amenities on the interior so that the carpeting and things like that may not have lived up to expectations in other units but like every homeowners no matter what you pay appliances wear out, heaters wear out, and you have to fix them. That is just the way it is. We have done that.

As far as garages and amenities like that we do have the same double car garage because we have no other parking and our CC&Rs require that we have to park within those limitations. So that is standardized. I think that I live next to somebody who did have a situation they ran into and they went bankrupt and they had a lot of personal things and they left. The City refurbished that unit and the contractor made a terrible error and the homeowners almost had to sue the City in order to have the person who took care of the contracting wouldn’t come up with paying for the damage that he caused the association which was very high. Finally, that all came together and it was taken care of. It could have happened with anybody but the homeowner’s association always looked at me like what is going on? The City is not living up to their end of it. So it works in many ways. I think that the purpose when we bought and we were also on the list for eight and a half years were people that wanted a good decent life, we were hardworking human beings, and it wasn’t a matter of everybody being at the high end or the low end. I think the purpose of this, what I see of below market housing is that we have everybody living in this city. We have the fire chiefs and the rocket scientists and the people that work in our restaurants and our school teachers, which are being priced out of our area. I think it is something to be thinking about. So I think that I would just like people to know the rules about homeownership in a situation. High Street is owned by the City if I am not mistaken. The City doesn’t have any percentage of ownership on High Street? So they were able to calculate by size of units? That could never happen in our housing complex everybody pays the same thing.

Chair Holman: Thank you very much. The next speaker is Lyn Hilton to be followed by Kate Mills.
Ms. Lyn Hilton, Palo Alto: Hi. I sent a letter in. I don’t know if you got it or not. I bought my
unit in 1985. I living in Oregon Green, I was renting there at the time, a three bedroom and my
owner wanted to sell it for $145,000. The BMR unit became available at $102,000. I was able
to stay in Palo Alto and the $40,000 difference was significant. Now I do live in a duplex and I
am not faced with the homeowner’s association fees as some of the other people here but we
have to maintain the outside of the unit. At a RIF, we know what that is, we have been quoted
somewhere around $40,000 fortunately we aren’t there yet but as you get into 22 years of
homeownership you need to start looking at these things. When I first bought the place I was
hoping that it would be a first homebuyer I would stay there for five years and leave. I thought
that the program was to help more people, more families, get into the program and move on but I
have become trapped. I would like to move. I really would like to retire from Palo Alto I can’t
afford to buy within Palo Alto and move on but the one-third appreciation there is nowhere you
can go.

A few comments were made that you can’t change the CPI because of the contract but yet you
are talking about changing it from 59 to 89 years. So why can you change one piece of the
contract and not another? I did do my initial homework prior to moving in and the CPI was
around seven percent for the ten-year period prior. So I felt in five years I would make a little bit
of money and be able to hopefully invest in Palo Alto but the prices obviously went up faster
than I could get my unit. That’s all I have. Thank you.

Chair Holman: Thank you. Kate Mills to be followed by our final speaker Karen Nelson. Did
Kate Mills show up again? Okay. Karen Nelson.

so that is about 11 years ago. I had been on the list for 12 years up to then. I had moved to Palo
Alto I guess it was about 15 years ago. I had moved to Palo Alto three years before being on the
list even but I moved into a rental house with a landlord who should be put up for sainthood
because in the 15 years I lived in the rental house my rent went from $800 a month to $900 a
month. I appreciated it and I hope he somewhere in Heaven hears me make this statement in
public.

At any rate, the BMR program, like Commissioner Tuma I don’t understand why a retroactive
appreciation formula could be considered a gift of public funds. But unlike Commissioner Tuma
I don’t want to see the appreciation formula in any sense tied to the maintenance of the unit or
the capital improvements of the unit because lower income families can’t always afford the best
maintenance or capital improvements. We have replaced all our major appliances but there is a
lot I would like to do that I can’t do just to put it bluntly.

Our homeowner association dues have skyrocketed. I can’t remember what they were exactly
when we moved in but they are now $450 a month and they will soon equal my mortgage. I
went to one of the homeowner association meetings when they hiked our dues and someone else
there complained. I don’t think they are in a BMR unit but when they complained the people on
the homeowner’s association Board said oh, but think of how much your unit has appreciated. In
fact the market rate units had in fact gone from about $200,000 when I moved in and I think they
are going for $750,000 now. So my unit that I think was priced a little under $100,000 at the
time I guess with the one-third CPI, can someone come up with a quick figure? It's probably not even $125,000 I don't think. Anyway, so much for that.

One other thing I don't really understand why the Staff is so concerned about being unfair to people who have sold their units and therefore are no longer in the BMR program as compared with the people who are still in the program. That is all I will say for now, thank you.

Chair Holman: Thank you very much. Commissioners, it is 9:15 I think we could stand a stretch. So let's take a seven-minute break and then we will come back.

Let's reconvene the meeting. We have one additional speaker from the public, Estelle Chalfin.

Ms. Estelle Chalfin, Palo Alto: I wasn't going to speak tonight until I heard the word 'financial windfall.' That really got to me. I bought an 850 square foot unit at Abitare in January of 1986. I paid $86,500 for my unit and my dues were $117.00 a month. My unit is now valued at $109,000. The same size unit recently sold for $950,000, our dues are currently $450.00 a month. When I bought my unit I was naïve, working very hard, and all I could hear was affordable and homeownership. I had no idea what the one-third CPI would do to the value of my home. There was no education from the BMR housing. Nobody explained it to me. We had ten minutes in the building to view the apartment and decide if we wanted to buy one there. It was still under construction when I moved in.

Abitare about five years ago had a $2.0 million assessment to the building. The BMR units were assessed at the same rate as everybody else. Fortunately we were able to obtain $30,000 loans from the City at an affordable rate, which will be added to my unit when I sell it. That means my unit will be sold for $30,000 for than the value it is now. Even if you add 100 percent CPI to the value of my unit it still won't be anywhere near 50 percent of the current selling price. Currently my homeowners due and my mortgage are more than 100 percent of my income. I am 69 years old. If the 100 CPI is not retroactive I will never see the value of my house, it will just have no meaning for me. I won't live long enough even if I sell it. So I hope you will take that into consideration. That is all I have to say.

Chair Holman: Thank you very much. I don't see any hands going up so I am going to ask a question. This would be of Staff and perhaps of Marlene as well since Marlene has the longest institutional memory here I am sure. It does occur to me that we are basing the conversation, and it just occurred to me this evening too that we are basing this resale on CPI and is that the right factor to use given people's comments and what do other cities use in their programs?

Ms. Siegel: Well many cities in Santa Clara County and San Mateo County have copied us and they calculate the resale prices using one-third of the CPI. Some use other similar indexes. There is a housing cost index produced by the same people that produce the Consumer Price Index and it moves a little bit differently but it wouldn't make an enormous difference in the amount of the resale prices. As I mentioned, some cities copy the formula used in redevelopment agency law, others use the area median income which has its pros and cons too, overall over the long term in this county it has gone up faster than the Consumer Price Index but we have these aberrations where HUD will suddenly recalculate their methodology and it might
drop or as has happened it stayed stagnant in this county for the last five years. So that would produce no increase in resale prices over that time period.

The Staff Report does describe what we established as criteria for selecting and appreciation formula. It is in the Staff Report to Policy and Services on page 5. The Staff actually differed from the consultants. The consultants recommended a different approach based on the change in the area median income with caps and floors and things like that. That was described in Attachment D to the Policy and Services Staff Report. Staff thought it was too complex to explain and administer. As you can see we have trouble getting the one-third of CPI across. I can’t really account for what was done maybe 15 years ago in the process of selling BMR units but Palo Alto Housing Corporation for the last five years has made quite an effort to do quarterly educational workshops for people on the waiting list to teach them about homeownership and home buying and financing and about the specific rules and responsibilities of the BMR program and the obligations under the deed restrictions. So we have really tried to ramp up the education component of things. We have also held workshops for existing homeowners and we had one successful workshop and then that seemed to take care of the interest and couldn’t really fill up subsequent offerings of workshops for existing BMR owners.

There are a lot of different ways you can run these programs and again you have to get back to what are your goals and objectives and then pick a method that meets those.

Chair Holman: Commissioner Sandas.

Commissioner Sandas: I am just wondering Cathy if we have any kind of tracking of the CPI against the increase in real estate value in Palo Alto. The CPI goes up a certain percent one year and the increase in Palo Alto real estate goes up, do we have anything that is like that?

Ms. Siegel: I think there are some charts like that in the Keyser Marston report.

Commissioner Sandas: On disc.

Ms. Siegel: If you like we can make hard copies for you.

Commissioner Sandas: I would actually like that, thanks. I just had another question that is a little bit off the subject but it was following up to one of Commissioner Tuma’s earlier questions. It just seems to me just based on economic conditions and based on the fact that as a Planning Commission we are trying to report trends to Council we are starting this new program and I am just wondering if adopting a new ordinance hinder us from having the flexibility to make changes to the BMR program as the economy changes? There are certain things in the economy that we couldn’t see coming at us, who knew Google and what Google was going to do and how that is supporting our higher real estate prices and the competitiveness in our area market? Who knew these things were going to happen and they have had results that clearly have an impact on our BMR program. So I am just wondering if we might just want to keep the BMR as a part of the Housing Element instead of an ordinance just for flexibility sake. I don’t really know the answer to that obviously.
Ms. Caporgno: I think that probably in a way the ordinance would be simpler to modify because if you change the Housing Element we have to send it back to the state. So with a BMR ordinance it can be done internally.

Commissioner Sandas: I had it exactly backwards in my mind.

Ms. Siegel: Also I might just add that I think the ordinance will make it much easier to deal with the developers. It will give us a much stronger base of strength in negotiating BMR agreements. It is not intended to cover every aspect of the program. It would be more detailed than what is in the Housing Element right now but there would still be a lot of things in policy procedures manuals that can be revised more easily.

Chair Holman: Commissioner Keller.

Commissioner Keller: Yes. It seems to me that the change from full CPI to one-third CPI occurred exactly at the time when the need for that change went away in some sense, exactly when it happened the CPI increase sort of moderated for the next 20 or so years. So in some sense it was like closing the barn door after the horses have left. I am wondering there is a comment here about affordability and the increase in homeowner association dues. I am wondering if there is any data about the increase of homeowner association dues versus the increase in rents over that kind of period. Maybe in the last few years or a small period it might be different but I am sort of wondering if there was some comparison of that and also if people who bought their units many years ago if they were renting those units today what would be the comparison between those rents for comparable units in today’s market, are they paying something less or are they paying something more than would be a rental for such a unit? Do you have any data like that?

Ms. Siegel: No, I don’t think we have ever looked at that. Certainly one could do that. Rents are really variable they shoot up and then all of a sudden the economy changes and landlords are complaining about all of the vacant units they have. Right now, the last three years, they started on a huge upswing.

Commissioner Keller: The next issue is that there was some comment about the older units being lower priced than the newer units. It seems to me that that phenomenon also occurs with for example for sale housing that if you have two houses that are essentially identical except that one was built a year ago and one was built 50 years ago that the one that was built a year ago would be higher in value just because it was newer even if everything else was comparable about it in terms of its state of repair and such. Do you have any thoughts about that?

Ms. Siegel: I think what is more of a parallel analogy would be if you look at a 40 year old modest three bedroom, one bath tract home what its value is going to be on the open market compared to a brand new home with fancy finishes and things like that. Obviously the brand new one is going to be worth a lot more.

Commissioner Keller: I am wondering if there is any data to the extent to which there has been a change in the spread of income levels as the median income rises. What I am wondering is does
the rising income sort of lift all boats in the same level or does the rising income affect people at different levels of income more? Does that make any sense? In other words, people who make more money are making more money and people who don’t make as much money aren’t quite increasing at the same rate?

Ms. Siegel: I think what you are trying to say is that maybe 30-some years ago the income of your social worker or childcare worker was maybe closer to the median income of the county and now some of those types of jobs I would suspect are a lot farther from the median income than they used to be. I think that is one reason we need to be careful and not just say that the BMR program should only be ownership for people that are in a narrow band of moderate income because we have the highest median income just about anywhere in this county as defined by HUD, $105,500 for a family of four. People at half that are considered very low income technically but they may have a very good job it is just not a job that is paying $100,000 a year. So the fact that we can serve some of these people earning $40,000, $50,000, $60,000 a year with resale units I think is a very good thing about the way the program has worked.

Commissioner Keller: My last question of this series is with respect to SB 1818. There have been some questions about whether we have proper ordinances that conform to SB 1818 that indicate what concessions we give to developers that provide the amount of housing that is indicated in SB 1818. Depending on what percentage of BMR you get a certain number of concessions. Considering that we require 15 percent anyway it seems that our ordinance should take that into account in terms of the amount of concessions people really get. So I am wondering if as part of creating a BMR ordinance in general whether this is an opportunity to codify what concessions we do provide with respect to SB 1818 so this question doesn’t come up in the future. It seems at least to me like a good opportunity to fix this and I am wondering what your thoughts about the potential for fixing that problem.

Ms. Siegel: Well, I think we have quite a bit on our plate just to get a BMR ordinance to incorporate the program as is and the recommended policy changes. It is certainly a good idea to deal with 1818 also. Some of our neighboring cities have been trying to deal with that and there might be some good models around to use when we have the time to work on that. I think if we try to get into that now we could end up delaying getting this project finished.

Commissioner Keller: I am wondering if we say something to the effect of you need to have a certain percentage anyway and therefore your concession is simply being allowed to build and if you basically provide only ten percent you don’t get anything extra, if you provide 20 percent you get something, and codifying exactly what that is might make sense.

Ms. Caporgno: Just to clarify, once a recommendation is made and the Council forwards whatever decision they make to Staff, and hopefully we will be going forward with a BMR ordinance, it will go to the Attorney’s Office and I know the Attorney’s Office is anxious to get a BMR ordinance completed. I can ask Melissa as far as adding 1818 to that. I don’t know if that is possible now. I know that is something the Attorney’s Office wants to address soon also but I don’t know if the combination of two is something that they want to address now.
Ms. Silver: I think probably the combination of the two is outside the scope of the three real issues that you are looking at tonight but SB 1818 is a state statute that we are required to comply with anyway. So whether we incorporate it into a BMR ordinance I think would probably be a policy decision as we develop the BMR ordinance.

Commissioner Keller: My reasoning here is that there was a development that came up recently in which additional concessions were provided for doing what the City already requires to some extent as far as our inclusionary BMR ordinance does. So in some sense it is a form of double dipping and so to the extent that we can fix that problem and only provide additional concessions to the extent that the developer is actually providing more than what we are already requiring seems to be helpful.

Mr. Williams: We can revisit that with the City Attorney but we have had at least one meeting with the City Attorney about including the SB 1818 issues in the BMR and I think they would like to keep it separate. Also it is my understanding from the legislation we are not going to be able to say your 15 percent is this and then you can’t ask for any bonuses but we may be able to define what those incentives and bonuses are specifically and put some limits on that and that kind of thing. So there is a lot to sort of study with that and if we could do that in the same timeframe and it meshes together that’s great but we can’t commit to that but we will look into it.

Chair Holman: Vice-Chair Garber and then Commissioner Lippert.

Vice-Chair Garber: I am still trying to get my arms around a couple of things so I have two questions. Help me understand a little bit more about the marketplace for these units. In most other places or perhaps some other places the value of real estate has to do with the amount of real estate that is being offered as opposed to the improvements on it, which may have some incremental effect, but underneath it is the value of the property itself or the land. However, Palo Alto has a bunch of other demands and there is not a lot of supply of land available, which drives up the cost for these things. In the condo market and/or the duplex market do the improvements create substantial increases to the value? I am thinking in terms of percent here. Is it more than ten percent, more than 15 percent? Do you have an idea of that?

Ms. Siegel: I am afraid I don’t really understand the question.

Vice-Chair Garber: If I were to sell my unit as an owner in an improved state or an unimproved state what is the difference in the potential selling price of that unit?

Ms. Siegel: You are talking about condominium?

Vice-Chair Garber: And/or a duplex, yes.

Ms. Siegel: By improved you mean the level of ....

Vice-Chair Garber: Finishes, appliances, things of that sort. What I am hearing is one idea is to create an incentive around making some improvements to the appearance and some of the
functional appliances of the units. I am just curious overall what impact that has to the selling
price, if you know.

Ms. Siegel: Well, the deed restrictions require that if an owner has done substantial capital
improvements and there is a price definition in there that then the City adds those to the owner’s
selling price but we are required to look at the age of the improvements and depreciate them if
they are not recent. So for example if you put in a new water heater 15 years ago it is probably
beyond its expected useful life and you wouldn’t get a credit for that on your resale price. I don’t
know if that is exactly what you are talking about. When people mention the sales prices of
market rate units in their development most likely a $900,000 Abitare unit is pretty fancy unit. It
probably has a completely remodeled kitchen.

Vice-Chair Garber: The real difference there is that is competing in the marketplace as opposed
to a marketplace where the demand is controlled by the City and others. That is the real
difference between a unit that is offered at $900,000 versus the same unit that is offered at
$125,000.

Ms. Siegel: Yes, there is no price competition for BMR units they are just sold based on a
formula.

Vice-Chair Garber: Your calculation. So question number two not necessarily related and again
I am not sure you are going to be able to answer this but help me just speculate here for a
moment. If 20 years ago or 24 years ago or whatever it was the decision was made not to mark
these units as one-third and the decision was to leave them alone, let them be 100 percent, where
would we be now with these units? Would these units be more difficult to sell? What would the
impact be today if that had never occurred?

Ms. Siegel: Well, first I think I should say something that I think the program really was in
danger of collapsing in the early 1980s. The situation was so bad for condominium units, the
interest rates were so high, and combined with the inflation of the CPI running as high as 15
percent increase.

Vice-Chair Garber: Collapse because the program couldn’t find buyers?

Ms. Siegel: They were searching really hard to find people that would buy the BMR units
because the market rate condos in those same complexes people weren’t buying them and their
prices were declining and financing was so hard to get. So they really were looking at a program
they just created and can they really keep it going? Now it is true that as soon as they adopted
the one-third CPI inflation did moderate so it was like closing the barn door after the horses ran
out.

Now we still have about 25 units left from the earliest days of the program with their original
owners and they still have the full CPI in their deed restrictions. So when they decide to sell that
is how their resale price will be calculated. So you can have a situation in one development
where a unit maybe turned over beginning early on fairly often so its price might be a lot lower
for resale than one of these original 25 that are still left. But the prices are well below the market
so we can still accommodate them.

Vice-Chair Garber: I am trying to see if there is a lesson learned that could be distilled here in
retrospect. Were there other tools and/or ways of managing through that issue now that could
have been employed other than the reduction of the CPI for these units?

Ms. Siegel: Well, they did use some other tools, they waived the income limits on units and sold
them to people that were over income but kept them in the BMR program. We had to do that in
about 1993. One lady spoke that owns one of these discount units that only occur in the Birch
Court Condominiums where there are 17 that were sold originally at much higher prices. They
weren’t really BMR units they were voluntarily contributed as sort of semi-affordable units at the
time but they have the deed restrictions with two-thirds CPI. We went through a period of time
where they were only $20,000 from market rate Birch Court condos and I think we lost three or
four of them. So there are unique problems with particular complexes and the retroactive full
CPI. I think we would have some issues in Abitare and in Redwoods partly because of the
special assessments that happened in those projects that are wrapped into resale prices and also
because the units are just small and modest and don’t have the appeal to our buyers for various
reasons.

Vice-Chair Garber: I have one more but I am going to pass because I need a moment to
compose. Thank you.

Chair Holman: Commissioner Lippert and then Commissioner Tuma.

Commissioner Lippert: If you could answer, does the BMR program take into account
individuals that are government employees or work in the public sector at all?

Ms. Siegel: There is a preference for live or work within the City limits of Palo Alto and almost
all of our buyers meet that preference. In the early years of the program there was a tiered
preference for teachers and City employees. I don’t remember exactly when they stopped doing
that. They found it difficult to administer tiered preferences and we have to keep the resale time
limits on units pretty tight and we should really even be tightening them up a lot more so people
can use other kinds of financing like CAL HFA. So tiered preferences get difficult they add on
to the resale time.

Commissioner Lippert: So the current program doesn’t really address teachers at all?

Ms. Siegel: Well, teachers can certainly buy. They would all work in Palo Alto.

Commissioner Lippert: But they don’t get any preference.

Ms. Siegel: They don’t get a special preference, no.

Commissioner Lippert: Or social workers.
Ms. Siegel: No, or City employees, or anything like that. There are a fair number of City employees and I think there are a fair number of teachers but I don’t have any specifics.

Commissioner Lippert: Okay. Then one last question. In terms of the 59 years for it to remain affordable housing, BMR, and then it reverts to market rate versus the proposed change of it going to 89 years. What is the rationale behind that?

Ms. Siegel: Well, the objective of the 59 years originally was at the time the program was founded was to preserve the BMR units in our affordable housing stock as long as they could legally be restricted. At that time I believe that was the advice the attorney’s gave the City Council. Our consultants did research on this issue and they found some communities just say they have to be affordable in perpetuity, others are using terms like 89 years, and things like that. At the other end of the spectrum the City of Sunnyvale established their program with affordability of 20 years and they hit that a few years ago and started losing units from their program like crazy and their Council is buying them back and has now adopted a longer term of affordability.

Commissioner Lippert: Why not look at something a little more tangible like lifecycle costs? If you look at a commercial building the lifecycle cost is really 30 years, you pay for that building in 30 years and you can rehabilitate it, but it has basically been bought and paid for, etc. With housing 50 years, 60 years, is really the lifecycle cost. People do improve and renovate them. Why not keep it in that 40 to 50 year range? They are going to demo it after 50-plus years anyway. It is going to get redeveloped by somebody and the least likely people to redevelop it would be the current occupant, whereas if it was redeveloped again whoever redeveloped that site would be required to provide more BMR units.

Ms. Siegel: Yes, that is an interesting point.

Chair Holman: Commissioner Tuma.

Commissioner Tuma: I have a similar question on the 59 to 89 but listening to the discussion it is more just a comment than a question. It seems like we are retroactively changing that component that is something that is a deed restriction now and we are talking about giving something in return for that but that would change. The people who have already held these, bought them at the time thinking it was 59 it would go to 89, right?

Ms. Siegel: I suppose it is a matter of a policy decision of whether the 89 years would only apply to new buyers in the future or newly constructed units or something like that. It wouldn’t necessarily have to apply to existing owners that decision could be made. In reality I don’t know that we would ever hit the 59-year with any one owner. When they do sell we put a new deed restriction on them and the 59-year clock starts again. So it would be a very unusual circumstance of somebody passing a unit through several generations. People are allowed to inherit the adult son or daughter of an owner is allowed to inherit the unit. We only require that they be within the maximum income limit for the program and of course they do have to live in the unit. So in most cases they don’t want to live in the unit and they sell it when they inherit it.
Commissioner Tuma: Okay, this goes to my second issue, which is just to get a clarification. One of the previous speakers said that when they bought it was inheritable and now there has been a change. Is that just a change or is that a different interpretation by the City Attorney? What is the status of then versus now?

Ms. Siegel: We have interpreted the language in the deed restrictions it was not clear. It said that the units could be inherited by certain people such as a spouse or the adult children of an owner but it implied that there were standards that they would have to meet but it didn’t describe them explicitly.

Commissioner Tuma: When was that interpretation? Was there a legal opinion from the City Attorney? When was that interpretation given?

Ms. Tronquet: I am not aware of it. I would have to check on it and get back to you because I don’t think our office is aware of it. It sounds like it was prior to the current City Attorney.

Ms. Siegel: I don’t recall if there is a formal, legal opinion but we definitely consulted with the City Attorney’s Office. We have issues all the time with people wanting to transfer units and more and more as people age we have had people asking to transfer title of a unit by gift or sale or a person passes away and there is an inheritance. So we have had to deal with this quite often.

Chair Holman: Vice-Chair Garber.

Vice-Chair Garber: Is the goal that was mentioned of keeping the existing BMR units in the stock of available BMR units, is that goal at odds with the other potential goal that was mentioned of creating wealth for the owners of these units?

Ms. Siegel: It depends on how much wealth you want to create. I think the original concept of the program in the mid-1970s was that BMR homeownership was ownership but it was in an old fashioned kind of sense where you didn’t really see your home as a profit-making investment that you built equity mainly by paying down your mortgage. You didn’t refinance every chance you got. It is kind of like how my grandparents owned their home in the Midwest. You bought for security and having pride of ownership and stability and things like that and other types of values. The CPI whether it was full or one-third appreciation was supposed to give the owner a modest return on their cash investment, their down payment and the equity they built up, similar to putting your money in a CD or something like that. They can’t lose money unless they totally don’t maintain their unit and we have to deduct for terrible deferred maintenance but they are guaranteed to at least have their purchase price in this modest appreciation. So that was the original concept. It is very different than you provide somebody an affordable unit once and then they can sell it maybe in ten or 20 years at market rate and walk away with the profit.

Chair Holman: Commissioner Keller.

Commissioner Keller: I am wondering how the list is ordered and how people are chosen from the list to be able to buy properties. I realize you don’t want to go into a long thing but if you
can sort of briefly describe it. Is the list ordered simply by longevity and the priority of living in Palo Alto and working in Palo Alto?

Ms. Siegel: Yes, that is correct.

Commissioner Keller: How do you decide which person on the list is allowed to buy a unit?

Ms. Siegel: Well the packets about the units go out to everyone on the waiting list and then people are allowed to attend an open house and express interest and they process the people that appear qualified from just a quick review of their applications in order of their number on the waiting list.

Commissioner Keller: So in response to Commissioner Lippert’s question if the sequence is based on their ordering in the list if you had a different way of ordering the list, for example you said that if there was some formula that said if you worked for the City or were a teacher or social worker or whatever then you could have a certain bonus pushing you further higher on the list that would simply reorder the list and it would be processed in the same manner. Does that make sense or am I confused?

Ms. Siegel: There are a lot of different ways to do it. Los Gatos has a point system. I don’t know exactly how they administer it but there are other ways of doing these things.

Commissioner Keller: There was talk about in some sense some guarantee of a price in some way and I am confused about that because after all one can only get the price if there was a willing buyer who is willing to pay that price. Suppose that the market doesn’t bear that price could the seller agree with the buyer for a lower price if that is what the market bears based on the quality of the unit and comparable or whatever?

Ms. Siegel: Well, I don’t really quite follow that. Technically we can do an appraisal if for some reason there was something unique about a unit that its real value was less than the BMR formula resale value. That would be an extremely unusual situation.

Commissioner Keller: So you wouldn’t expect that maybe a new unit that somehow the market collapsed and maybe there wouldn’t be a way to sell it. You think that there would always be somebody that would want to buy it and that there would never be a problem?

Ms. Siegel: Well, recently the City had to buy a unit because we couldn’t find anybody that would buy it and we ran out of time to sell it.

Commissioner Keller: So you bought it for the “guarantee price,” for the set price.

I am wondering what happens in the event of an earthquake or other disaster. What happens in that situation?

Ms. Tronquet: I think is probably outside the scope of the three things you are looking to make a recommendation on tonight.
Commissioner Keller: Okay. Thank you. Could you give an estimate if we did a retroactive increase to CPI based on the date of purchase? Is there an estimate on what the greatest increase in value there would be? I presume that the older units would have a lower base and therefore the increase wouldn’t be that great. The newer units the base is higher but there are fewer years for it to appreciate so that balances out in some way. Do you have an idea of what the greatest increase would be? Your comment was $50,000 is that basically the largest it might be?

Ms. Siegel: You analysis is correct about what you said about units of different ages. Basically the units that were first sold when they adopted the one-third CPI the difference between then and now is about 120 percent change in the CPI index. So if a unit cost $50,000 then it is basically about $120,000 or something.

Ms. Caporeno: Just kind of anecdotal one of the last speakers indicated that she purchased her unit for $85,000 and I think she said it is worth $115,000 now and that is under the one-third CPI. So I think that her unit under the full CPI would probably be worth $175,000 now. It would be $60,000 more because there was a $30,000 differential. So with a full CPI you would get three times what the current increase is. I don’t know if that helps at all.

Commissioner Keller: Yes, so we are basically talking about somewhere on the order of $50,000, $60,000 to $70,000 and probably not much more than that for anybody in the program. Thank you.

Chair Holman: Vice-Chair Garber.

Vice-Chair Garber: Trick question on item 1G, which is regarding the developer’s policies. Clarify the City’s Priorities for Satisfaction by Developers of the BMR Requirements. Does the City currently do that? Does it have a list or something? I apologize if it does you have probably shown it to us and I am just not recalling it. Is there a list of priorities that we give out to developers of these things?

Ms. Siegel: Yes, in the Housing Element. The program talks about land dedication and provision of units and offsite units but it is not very clearly written.

Vice-Chair Garber: Okay, I was thinking it might be some separate report or something. Thank you for that clarification.

On item number 1E could you just walk me through briefly the differences between those two? I know there is a paragraph of the cost versus mortgage based calculations but could you walk me through that difference?

Ms. Siegel: This is a clause that has been in the Housing Element I think going back to day one before these programs were very well established. It was supposed to be kind of an escape clause if a developer thought they were really getting a big hit on their hard costs of building BMR units. They could come in and try to get us to agree to allow them to sell them for more than our price based on affordability formulas.
Vice-Chair Garber: I spent X so I need to sell it for Y.

Ms. Siegel: Yes. In reality this has virtually never been used and our consultants informed us that no other community that they knew of had a clause like this in their program. They said these programs are well enough established that you can use an affordability formula to determine the developer’s prices and it doesn’t matter what the units cost them to actually build.

Vice-Chair Garber: It is a supply side equation in that you are looking at what somebody can afford and then basing that price on that as opposed to....

Ms. Siegel: Yes, basing the price on what your target buyers can afford.

Vice-Chair Garber: Thank you.

Chair Holman: I had a couple of other questions too. One relates to 11, number 1, In Lieu Fees for Fractional Units. Does the City ever require that fractional unit to be built? In other words, if the number of market rate units triggers a partial in lieu fee as this is stated would the City ever require the developer to build that unit?

Ms. Siegel: In large projects of 30 or more units once it is .5 or bigger we round up and the developer has to give us the whole unit and below that we adjust some other way like one more three bedroom unit or something like that. In small projects the fractional units are sort of more critical to the developer’s profit line so we take care of the fractional units with a fee. It would be very occasional that a developer would be willing to voluntarily round up. Say if they owned 1.6 units that they would voluntarily give us two units in a small project. That would be unusual.

Chair Holman: Did you have a follow up, Commissioner Burt? Thirty units as opposed to 20 units say? Why 30?

Ms. Siegel: When we did the 2002 Housing Element that is what we picked as sort of a reasonable threshold for large enough units to be rounding up. It is a judgment call.

Chair Holman: Okay. Then under Policy 2A, “Allow substitution of smaller units only if more BMR units are provided by the developer otherwise BMR units must meet City comparability standards.” My question is because this is general I can see situations where a developer might be building units that are 1,800 square feet or 2,000 square feet but want to provide two smaller units that are 700 square feet a piece. So are you anticipating that this language is going to be fleshed out more so that there would at least be a square footage comparability?

Ms. Siegel: Yes, yes we would flesh it out and have written policy that described the parameters of what would be acceptable.

Chair Holman: So will that language be going to Council when this goes forward because we don’t have it?
Ms. Caporgno: No, these are the three policies, 2A, 2B, and 2C. All we wanted from you as well as the Council are these things that you think are viable for us to explore further and then we will do that during the Housing Element. The Housing Element will be revised in the next couple of years so that will come back to you as actual language for your recommendation to Council at that time.

Right now what we are trying to get from you is whether or not you think these are even worthy of our going forward with them and coming up with that explicit language.

Chair Holman: What I was looking for is like maybe it is, maybe it isn’t, it depends, is why I asked the question. So you get the drift.

Then also 2B, could you give an example of that, please?

Ms. Siegel: Well, a hypothetical example would be say a site that is maybe six acres or something like that, big enough to trigger the 20 percent requirement on the developer. Currently sites of five or more acres trigger a 20 percent BMR requirement. Say the way the site was configured you could carve off a portion of that site and reasonably develop a rental housing project on that portion. So the city would ask the developer to dedicate a portion of that site and then they would have to process that through entitlements so that it would be entitled for a development of rental housing that would at least provide the square footage of housing that would have been in the BMR units in the project. So presumably the rental housing units would be smaller and there would be more of them. You would have to negotiate exactly what was entitled and then the city would presumably, usually most communities that do this the developer has to provide the utilities and things like that, the infrastructure to allow that housing to develop. So the city receives a piece of land that is entitled for the requisite number of units, has its infrastructure, and is ready to build. Then the city can issue an RFP for rental housing developers and do something like was done by Palo Alto Housing Corp. at Oak Court where they bring in tax credits and things like that and build very low income rental housing. You end up serving a different level of housing need and with more units than you would have had in the ownership housing.

Chair Holman: Okay. I think I had one other question. Yes, 1A, if you could just briefly describe, if that is possible, your or Marlene either one, kind of describe – I had asked if Marlene was supportive or comfortable with a cap if we went to 100 percent CPI. What kind of cap are you considering or would you think would be appropriate? Either of you or both of you.

Ms. Siegel: Well, what Staff had thought of was to look at the maximum price that would be affordable using the way we calculate brand new BMR units being built at the 120 percent of median income. That would reproduce those prices each year based on one, two, three bedroom and studio units. So for the older units that would establish a maximum price and that would include any special assessments that were wrapped into that resale price.

Chair Holman: Okay, and I think maybe my last question and then I will turn it over to a couple other Commissioners. On page 4 of the Staff Report it says, an alternative idea to a retroactive change in the appreciation formula is a one-time bonus. Staff is suggesting $25,000 would be
added to the resale price if a unit were in excellent condition when it offered for resale. There is a bit of an adjunct to that too as people – you gave an example early on in your presentation about people aging in place in these units.

I think the conversation tonight indicates this would have been a good topic to have a study session on prior to this meeting because there is a lot of interest in it obviously.

In addition to the requirement of whatever the percentage is 15 or 20 percent of the BMR units that a developer is required to provide I am interested in seeing if this would be an appropriate time to bring up the developer also providing the funding for a maintenance program so there is a per unit fund that is started. Again, it especially addresses people who are aging in place but as homeowner dues go up it seems like that is a way rather than putting it onto the City it is a way to help ensure as best as possible that these units are well maintained and maybe even improvements are made.

Ms. Siegel: Well, that is a good point. Ironically when they started this program so long ago they commented that it was a wonderful program because the City got free affordable housing and it really didn’t cost the City anything. As the program ages we are finding more and more there are issues like this. We started the special assessment loan program and now we think we need a loan program to help owners renovate units and we have higher and higher administration costs, and legal costs keeping them out of foreclosure. There are a lot of issues with running these programs in the long term.

Chair Holman: I think Commissioner Tuma and then Commissioner Keller or Burt. I am not sure which was next.

Commissioner Tuma: I guess I got accused of opening the can of worms before and a few of us have tossed a few of the worms out, now I am going to flip the can upside down. We were just handed a page I think it was possibly out of the original report. One of the members of the public brought it in and copies were made for each of us.

The key recommendations of the BMR study under Section D there is a section called Appreciation Formula and Affordability of Resale Units. There are four bullets under there. These are consultant’s criticisms of the current one-third CPI appreciation formula. One of those criticisms was that the CPI, especially one-third of CPI, has not provided owners with enough appreciation to refinance in order to complete repairs and improvements. So it seems like they are saying that one-third was not appropriate and also BMR programs should place more importance on owner’s accumulation of equity than on having the BMR units become more affordable over time. So those comments or criticisms from the consultants seem to be directly in contradiction with what is being proposed here. Am I missing something?

Ms. Siegel: Well, Staff does agree that the one-third CPI should be changed to full CPI, which is tripling the rate of appreciation compared to what is currently in place. Keyser Marston did recommend something completely different. I think I said maybe several times there are a lot of different approaches as to how to run inclusionary housing programs. Many communities copied us and have that one-third of CPI in place and seem to be happy. Communities use completely
different things. The realtor’s association is advocating that we should copy the City of Santa Clara. I am not quite sure what they do. I know the City of Salinas a couple of years ago had a system somewhat similar to ours and they just trashed it and went to an equity sharing system. So there are a lot of different things. You have to come back to what is most important to you in terms of policy objectives.

Commissioner Tuma: I recognize that there are lots of different ways. I guess I didn’t make my point very eloquently here is that we seem to acknowledge in here or at least the consultants say that what has happened in these intervening 24 years was a essentially not a good result. That is how I read it anyway. It seems to me we have an opportunity to fix that.

Ms. Siegel: I think there are good and bad points. A lot of people bought homes at very reasonable prices because of that one-third of CPI. So was that bad? Should those people not have been able to buy and people with higher incomes have bought because we chose not to change it?

Commissioner Tuma: But didn’t you also say that even at one percent those houses today would still be quite affordable. The result has been that they have been driven down to very low or low income and maybe that is not consistent with the idea behind the BMR. I think that is one of the conclusions that the consultant came to. So I am not saying by any stretch that they should go to market rate but I think my view on this is pretty clear.

Ms. Caporgno: Cathy, correct me if I am wrong, but my understanding is that Keyser Marston never recommended any sort of retroactivity. They were just recommending a change, which we supported. I think the reason that we didn’t support their methodology wasn’t because there would be a lot more appreciation accruing to the homeowners but it was just because it was very cumbersome. So we were anticipating that they would probably be comparable as far as the appreciation it is just that we wanted something simpler to use.

So we have another consultant, I didn’t hear you mention that before, but we had another consultant actually look at the appreciation. We didn’t come up with the full CPI ourselves we had somebody else who was kind of renowned in this area look at it after Keyser Marston completed their study to see if there was any way of kind of salvaging what Keyser Marston had done to make it more understandable to everyone. Then he recommended the full CPI.

Chair Holman: Commissioner Burt to be followed by Commissioner Keller.

Commissioner Burt: Okay. I think now we are back again to what retroactive is referring to and I think the Staff Report when it goes to Council needs to have some better clarity on which retroactive we mean. Now I just heard Cathy say that the Staff is in support of the retroactivity of this applying to or is that the case?

Ms. Siegel: No, I didn’t mean to say that.

Mr. Williams: Let me try to clarify this. Staff is in support of all new BMR units at full CPI, first. Retroactively Staff is not supportive of applying full CPI to units that were under the one-
third CPI. Staff is supportive of those existing units from here on being allowed to be dealt with
under the full CPI but for the years prior to now the one-third CPI has been in place and that is
contingent on this new agreement that has certain different provisions in it being signed.

Commissioner Burt: Okay. Then it goes without saying you are not supportive of retroactively
giving to people who recently sold.

Mr. Williams: Right.

Commissioner Burt: Okay. Having received that clarity now Staff did reference a concern over
fairness as well as this potential maybe legal issue. Isn’t there also a concern for fairness for
those who bought prior to 1984 who do have the full CPI benefit and that still carries forward to
today? Is that correct? So there are two halves to this fairness issue then, right?

Mr. Williams: You mean that they get the full one percent and somebody later gets one-third or
two-thirds?

Commissioner Burt: Yes, the ones that bought prior to 1984 get the full CPI and the ones that
bought after 1984 get only one-third of CPI so that is a fairness issue also.

Mr. Williams: It is a fairness issue. It is also a ‘that’s what they signed up for’ kind of
contractual issue as well. I think the issue is a policy issue for you to decide what you believe is
fair and to direct us that way and not get bogged down with the legality issue as you mentioned
before.

Commissioner Burt: Okay, good. And not get bogged down with a half of an equation of
fairness. It is just clear that it was not intended by any party but what happened was not only did
the CPI go down after the horse left the barn but that horse kicked the barn because the cost of
housing shot up at the same time. So you had two factors going in opposite directions that
created this huge disconnect. We are not talking about a little nominal disconnect between their
appreciation and .... yeah. So we need to lay those cards on the table and these people are not
going to have some huge windfall. From what we have heard this is a minimum impact of a CPI
at 2.7 percent a year. We are all familiar with the housing markets not only what has gone just
crazy in this area but in outlying areas in the last decade the appreciation went on a percentage
basis even higher. So people seem to be as much as it is hard for us to imagine people trapped in
Palo Alto but people are. They can’t afford to leave these homes if some of them have reasons
that they want or need to move to another place they have almost no appreciation after 20 years
of homeownership.

Sorry, and the Chair will clarify this, we appreciate your support but we need to keep this to
Commission comments for the time being.

Chair Holman: Actually, if we are finishing up with questions we could start comments.

Commissioner Burt: Yes, I am onto comments. Okay. So I think this approach going forward
of the indexing to the 120 percent of median we are never going to hit that anyway. So that cap
is no problem. It is a no harm, no foul cap. Nobody is going to get there unless something
radically changes in what is happening in the market these days.

I also have an additional concern and it probably is just a recommendation that we evaluate and
that is this issue on the home maintenance fees or the condo maintenance fees or whatever it is. I
am aware that these things even at market rate units have driven homeowners out of their homes.
We have an inherent conflict of interest that occurs when you have market rate units and if the
market rate homeowners are 80 percent or 85 percent of the occupants and not only do they have
the money available to them to pay for upkeep and even upgrades, which happens in some
of these units in complexes, but that they get the appreciation from that. So the very low-income
people or low-income people are being forced to pay at the market rate for something they don’t
get to recapture the benefit of the market rate. That is a big problem, and that was never
intended by the City.

It is not the fault of the program or anything but it is a reality once again where we are looking at
changes that have happened in the market and some of this stuff has crept up on us over 20 years
and I don’t want to wait another 20 years to fix a problem. So I think we need to lay that on the
table. As I recall Sunrise development on the senior housing voluntarily offered to subsidize the
essentially membership dues or whatever it was of those units. It wasn’t obligatory but it was a
really good thing that they did. Otherwise people could come in and then they couldn’t afford
staying there after awhile. They had BMR units but the fees were too high. So I would really
like to see us look at a program that will try to come up with a means to include the ongoing
costs associated with residency on these collective costs fall under a subsidy program. Maybe
we can’t go all the way to making it so that there is no disproportionate impact. If you look at
comparative incomes in comparative housing levels if they were paying half of what the market
rate is they are still paying a higher percentage of their disposable income than are the market
rate people paying for the same benefit. So I am not sure what is the right balance but it sure
seems like some correction we need to pursue and explore. I hope that it would be something we
can do legally within our BMR program. So I think those are my main points.

Chair Holman: Commissioner Keller, comments.

Commissioner Keller: Actually I want to ask one question first and then I will go into my
comments. The question is with respect to the CPI change to one-third. It seems to me that part
of the problem is that we were dealing with high levels of CPI and rather than switching to an
annual cap on the CPI there is a switch to a third. If instead for example we used the CPI with a
cap of say three percent or five percent or some number like that compounded annually we
wouldn’t be in this problem today. Because it would have adjusted and it would have had the
effect with the same intent as before but it would have a different effect as now. So I am
wondering whether it makes sense to instead of thinking about the cap in terms of the
affordability of numbers if it makes sense either in addition to that or instead of that have a cap
of the form CPI plus with a cap of say three percent compounded annually or whatever the
appropriate percentage was but in some sense that deals with the potential that the high deficits
that the government has been running and the larger balance payments that we have been
running might not lead to a high inflation in the future. So I am wondering whether an annual
cap not taking one year but basically accumulated over the entire period of the ownership might
make sense instead.

Ms. Siegel: I think that is another approach that could be taken. There are different ways of
getting at it. The cap that we proposed based on the 120 percent of AMI maximum new unit
price can cover lots of things changing like interest rates changing or special assessments or
things like that. So it kind of encompasses a lot of different things but a cap as you suggest is
another system that could probably work.

Commissioner Keller: In some sense it allows for the creation of the intent that was provided in
the change in 1983 and if we had that change instead we wouldn’t be here today with this
problem. So I will just indicate that. If that were the case do you think that three percent was
reasonable? What would be the reasonable amount that would make sense for that? Do you
have any idea? What has been the average annual CPI over the last 25 years? Do you have an
idea what that is?

Ms. Siegel: I think since the change to one-third of the CPI I think I had figured it out and it was
about 3.3 percent over that time since 1984.

Commissioner Keller: So if we basically set it to a compounded annual cap of four percent that
would cover that plus a little bit more and it meant that if we had a period of high inflation in the
future we wouldn’t get out of hand and come back and revisit this and say here is a problem we
have to deal with again. So it would sort of automatically adjust that way. Does that make
sense?

Ms. Siegel: Yes, I am not sure what you mean by compounded because the way we calculate the
change in the CPI isn’t the same as compounded interest.

Commissioner Keller: Well, if you put a cap on there you want a cap that is compounded
annually as opposed to a cap that is straight. So for example if you go on for 12 years, let’s say
you go on for ten years it is not 40 percent increase it is 1.04 to the tenth power. So it basically
increases. For those of you who know about compounded interest it is actually compounded
appreciation as opposed to compounded interest.

Let me give you the rest of my comments. The next comment is that I believe that the full cost
of improvements should be included if they are in good repair. That to me is an incentive to do
improvements and that we should generally do that and be very liberal in terms of allowing that.

The next thing I would encourage to the extent that there are amendments to the deed restrictions
that those amendments state the new base valuation explicitly so that there is no confusion in
future calculations if the formula changes or whatever. You say here is the new rate as
calculated at this point and then you have a formula that indicates what it is in the future.

The next thing is that large assessments should be added to the value for resale and that should
be an automatic situation. So people can finance large assessments as an automatic process.
The next thing is I think that we should analyze the policy changes for 2A, 2B, and 2C. In terms of that we should consider the amenities and the finishes in terms of differential provided and also consider whether the BMR units provided are sale or rental. For example if the rest of the complex is for sale and BMR are provided for rental that is a differential that affects because of the income that goes to the developer.

With respect to the issue of limiting the homeowner association dues the thing to consider there is that the effect of reduction of price for BMR units is something that the developer pays for that the other homeowners don’t directly pay for. They pay for it indirectly but they don’t pay for it directly. In contrast a reduction of or an adjustment to homeowner association dues for a BMR unit would be paid for directly by the other homeowners of that complex and I think if you were to do that it would actually reduce the City support for BMR units, people who own the other condos, and that would be problematic in the long term.

I would like to see a recommendation that when these policy changes are considered that we concurrently as part of that process consider implementing SB 1818 in our ordinances. Not necessarily in the immediate ordinance but as part of the policy changes we implement in the next stage. I would also like us to consider the feasibility or the potential for creating an entity that buys BMR resale units, fixes them up, and sells them for the incremental cost of that fix up so that we have the situation that when units come on the market there is a potential for them getting better. It appears to me that the Palo Alto Housing Corporation is not setup to do that. That is not their mission and charter. They are not able to do that. To the extent that some other entity were to do that it would make a lot of sense and would deal with the maintenance of these issues. Part of the complaints that were brought up earlier from my understanding one of the complaints was that when people bought these resale units they were not necessarily in a state of good repair. So this would be a way of solving that problem.

Ms. Tronquet: Chair Holman?

Chair Holman: Yes.

Ms. Tronquet: You have less than 15 minutes before your scheduled end time of eleven o’clock so I think it is probably time to close the public hearing and get a motion.

Chair Holman: Scheduled end time? We can close the public comment, yes. We are going through one round of getting comments and then we will get a motion. So we are aware of that. Vice-Chair Garber.

Vice-Chair Garber: Sorry, two questions. Would review of the rate of appreciation occurring more frequently relieve the need to have a floor and ceiling system in place for the appreciation? If you were to review those issues every two years or every three years you could adjust depending on what the marketplace is versus putting in a floor and ceiling.

Ms. Siegel: Well, the deed restriction that the BMR owners sign when they buy a unit is a form of contract in essence. The appreciation formula has to be spelled out in that contract. So if you want to have floors and caps you have to spell it out in that contract.
Vice-Chair Garber: In other words it would be too cumbersome because you would have to go through each individual deed to accomplish that.

Ms. Siegel: Well, if you can some up with a system that you can write into the deed restriction document but you can’t go opening up these things every five years with hundreds of owners.

Vice-Chair Garber: In other words, it might be a tool language, legal tool that said based on the every three-year evaluation of the marketplace that is done by the City or some other agency the appreciation rate will be X, something of that nature.

Ms. Siegel: Well, you can reevaluate it and change it going forward as we have proposed at this point.

Vice-Chair Garber: Yes, I am not talking about … I am just trying to understand.

Secondly, in the circumstance where you do go to 100 percent appreciation it is much easier obviously to create BMR units when they are first being built because you are asking the developer of that property essentially to pay for those units really because they don’t get to sell them for the price they would be able to get if they put them on the regular marketplace. If they are appreciating 100 percent they at some point or another they are going to become too expensive and grow outside of the BMR program, is that correct?

Ms. Siegel: I kind of lost you there.

Vice-Chair Garber: Someone is going to buy it for $100,000, X years later they are going to sell it for something more than that. Then they sell it and the next person is going to buy it for something more than they purchased it for. At some point that unit is going to have a value that is greater than what someone that is on this list can afford. Am I understanding that correctly?

Ms. Siegel: Well, it doesn’t seem to be too much of a problem by using the Consumer Price Index because historically as has been pointed out it has increased much more slowly than the median income over a long time and the market rate housing in this area.

Commissioner Burt: Not only is the CPI index historically lower than the housing increase index but the baseline would still stay discounted. So it would be still two factors that would keep it below market rate.

Vice-Chair Garber: Thank you.

Chair Holman: Commissioner Tuma.

Commissioner Tuma: I will try to make this a little bit simpler. I would align myself with the comments of Commissioner Burt that he made. I agree wholeheartedly with everything he said on this particular topic.
I will add two additional things. One is I would like to see the 59 to 89 years only apply to new
owners of a property. That doesn’t mean for any new units but that any current owner still has
the 59 years. If they sell then it goes to 89 and any subsequent units are 89. I think that is kind
of a fair way to not change the rules after they have been in effect. I am not sure how much of an
affect it will have but it just seems a little fairer to me.

The other thing is I would like to see a recommendation from Staff on what makes sense to
review on what periodic basis so we don’t get into this situation again. We can’t do it in such a
cumbersome way that we have to go back to every single deed every five years but there must be
some things we can look at every X years, three years, five years, ten years, whatever it is to
make sure that we don’t get into this situation. If we codify it and build it in then it is something
that will happen as a matter of course and we will review those numbers. We can do what this
program was meant to do which is keep things equitable as we go forward.

Chair Holman: Commissioner Lippert.

Commissioner Lippert: Well there is not much here that I have heard that I am not in
disagreement with. With regard to Policy 2A and 2C however, I really think that that should be
based on a percentage of floor area is really where we should be going in terms of looking at
units rather than actual units. Then it is really the amount of pie we are looking at not how we
slice the pie.

Also I think what would be appropriate is to begin to look at prioritizing below market rate units
for government and civil employees that live and work locally. Again, I think Cathy Siegel had
mentioned that there are sliding scales that communities have looked at in terms of a point
system perhaps, how long you have lived in the community, how long you have worked in the
community in terms of school. The idea here I think is that what I would want to do is use a
carrot and a stick approach which is to try to retain those people here. So what I would want to
do is upfront I wouldn’t want to allow them the full CPI. I would want them to live in that
housing for a period of time and not cash out with the full CPI at 100 percent and maybe move to
the central valley where they have the full equity. That is a thought in terms of being able to
retain people that are teachers or social workers that live here. Then after a period of time it
would go to the full CPI. I see it as a graduated system of some kind.

Then what I think is probably the most important is that I am not in agreement with changing it
to the 89 years. At 59 years those people have lived in this community, they have worked very
hard, they should be the beneficiaries of full equity in 100 of the market value of those units and
being able to sell those. Those sites are going to get redeveloped so somebody is going to buy
the apartment building or condo. They are going to knock it down. Those people should be able
to pull their equity out, cash out, be able to afford a retirement home, be able to afford the
medical care that they are going to need in the future. Another way of looking at it is if that
building exists they can take that equity and they could then turn it into a reverse mortgage plus
their pension. So there are ways of taking that and rewarding these individuals, these
homeowners, for being good citizens of Palo Alto. I think it is our job to come up with creative
ways of making that happen and increase the Below Market Rate housing market as well. Those
are just a couple of thoughts that I have.
Chair Holman: Commissioner Sandas, comments.

Commissioner Sandas: Just a couple. It is nice going last because everybody says everything and I don’t have to say too much. I do agree with many of the comments that my colleagues have made. To my mind whether homes are bought at market or below market homeownership is homeownership no matter what. It is a source of security and a source of pride for anyone who has the opportunity to buy a home. I don’t think homeowners should be penalized for buying below market. We need more BMR in our community. We want more BMR. I say we, and I hope I am speaking for a lot of us, we want the BMR program to continue with its high level of dignity and to be well subscribed and provide Palo Alto with some economic diversity.

So having said that I would like to take a look at mitigating the cost of homeowner association dues for BMR owners. It doesn’t seem quite fair that people are putting in market rate to maintain the property and not benefit from market rate. So I hope we can figure out a way, I don’t know what the channels are to negotiate with whom and for what to negotiate normalizing the fees for BMR homeowners.

I am in agreement with the 100 CPI and changing the deeds of those owners who now have the one-third CPI as recommended by the Staff. I think that is it. Oh, one other thing I am looking at Commissioner Tuma and wanted to say that I support the notion of having the flexibility in whatever ordinance is developed so that we can come back and look at it more frequently as things in the economy may or may not change.

Chair Holman: Okay I will be brief. There are some things that we won’t get to cover tonight but I am interested when we talk about this again in what kinds of concessions are sometimes made to developers and what the basis for those might be. In the pre-meeting yesterday Commissioner Garber and I were talking about amenities and sometimes when amenities are negotiated let’s say and some way to do that in a way that is equitable to the new homeowner. One other thing to put on that list Commissioner Garber is to the extent that the City has any control to look at parcel tax opt out programs because that can really make the difference between someone being able to in their home and not.

There is a question that I have that probably won’t be answered tonight. Because these are sold on the open market but managed by, in other words, market realtors sell the units, is that correct? It is not? The City sells the units literally?

Ms. Siegel: No, an owner, a seller, or buyer could hire a realtor if they wanted that support and advice but normally they don’t.

Chair Holman: Okay. All right, nix that one then. Other than that just the couple things I mentioned earlier which is I think going forward we ought to look at a developer fee for a maintenance pool to provide low or no cost maintenance incentives for the owners. Yes, the durability of the units. I would hope that as construction practices get better and we have more green building that we are not in 59 years tearing things down and rebuilding.
Commissioner Burt.

MOTION

Commissioner Burt: I am being signaled to attempt a motion and I am not sure at this late hour
my brain is wrapped around it well enough but I will make a stab and then be open to
amendments to the motion from fellow Commissioners.

So I would move the Staff recommendations with a clarification just in wording on number 1
where it states adopt the full CPI appreciation rate for new BMR units and all existing BMR
units, it says ‘with’ and I believe that would be more clear ‘that currently have’ the one-third CPI
formula. The second ‘with’ should be ‘and include’ a cap on the maximum resale value so that
within that we include a retroactive 100 percent of CPI appreciation rate for any current
homeowners.

Second, that I would like to add a Commission request that Staff work with the Housing Corp.
and evaluate prospective methods to mitigate the impact of homeowner dues on BMR
homeowners without predetermining what method that might be or it achievability but to pursue
it.

Also adopting Staff recommendations 2, and then under 3 to adopt A through C. Does that seem
to capture the outline of the motion? So it would be Policy 2A, 2B, and 2C would be included
within our recommendation.

Chair Holman: Is there a second to the motion?

SECOND

Vice-Chair Garber: I will second.

Chair Holman: Commissioner Garber. Commissioner Burt, do you need to speak to your
motion?

Commissioner Burt: Well I think this has been a very healthy discussion tonight. I think the
Commission has learned a great deal that we did not understand. It is a complex issue and it is
something that I think that all the parties are working to try to understand how we can balance
the interests of the parties of the homeowners, the interests of the Housing Corp. to provide as
many housing units going forward for needy members of our community who are providing
valuable contributions to our community and we wish to be able to be long term contributing
members to our community, and I think all of the parties have those common interests. I hope
that we are moving in a positive direction toward fulfilling them.

Chair Holman: Commissioner Garber, would you care to speak to your second?

Vice-Chair Garber: Very briefly. I think it is extremely difficult to argue against someone, a
homeowner, a property owner, from increasing the value of their equity through their ownership
of a property. That is one of the fundamental opportunities that are afforded in our country. It is an important thing for us to acknowledge and to support. The issues are not without burden for the City and the Palo Alto Housing Corporation and other agencies that support this. Those burdens may be great and we have not talked a lot about those but those are things that I would expect to be evaluated as part of some of the suggestions by Staff. To that end I think that is the extent of my comments at the moment. I would also encourage as the maker of the motion has additional amendments to further modify.

Chair Holman: Commissioner Keller and then Commissioner Tuma.

Commissioner Keller: First I am assuming that they are only BMR units with either full CPI appreciation or one-third appreciation, is that correct? So there is no need for any other?

Ms. Siegel: There are 17 units at Birch Court Condominiums that are called discount units and they have two-thirds CPI. They also have higher base prices. They weren’t required BMR units. The project was developed by Palo Alto Housing Corp. and they voluntarily provided extra affordable units so they are kind of an aberration. There was one person here that owns one that spoke about it.

Commissioner Keller: Would you recommend that that be included in the ordinance? So I am going to suggest that the amendment also include the ones at two-thirds CPI as well.

Commissioner Burt: That would be accepted.

Vice-Chair Garber: The seconder accepts as well.

Commissioner Keller: The next amendment I am going to propose is that in order to deal with not having the problem of a high rate of inflation coming in the future that the overall increase be capped by a four percent compounded annually accumulative over the life of the ownership.

Chair Holman: Does the maker accept that?

Commissioner Burt: It sounds reasonable. I haven’t thought it through. Curtis, did you have any comments on that?

Mr. Williams: I guess I am a little concerned that there is a lot of uncertainty with that. My gut reaction is that that will probably never be close to Cathy’s cap that she delineated of the 120 percent of current median but that is a very good cap in that we know what that is and that assures us that we have moderate priced units.

Commissioner Keller: I am not suggesting replacement of her cap I am suggesting that it be either/or whichever is less so that if we have a period of high inflation like we had from the late 1970s to 1983 that we don’t have these units appreciating. That is what I am talking about.

Mr. Williams: If it is either/or that is....
Commissioner Keller: Whichever is lesser.

Mr. Williams: Yes.

Vice-Chair Garber: Perhaps the language might be more like Staff to explore this particular option and make recommendations based on this.

Commissioner Burt: Yes, I think that it is worthy of evaluation. At this late hour I just don’t feel sure enough and I would be comfortable with requesting that Staff explore that and make a recommendation to Council at the time that this forwards to Council whether that should also be included. Would that be okay with you, Arthur?

Commissioner Keller: Yes, thank you.

Commissioner Burt: Okay.

Vice-Chair Garber: The seconder accepts.

Commissioner Keller: The next amendment is that the full cost of improvements be included in the valuation if they are in a state of good repair and that any large assessments be added to the value for the base if you will. Neither of those are increased by CPI.

Chair Holman: Maker?

Commissioner Burt: Does Staff feel comfortable with that concept?

Ms. Siegel: We currently do add all special assessments and yes, we don’t apply the CPI index to that neither do we do that to capital improvements. So the only difference in what you said was not depreciating them and capital improvements.

Commissioner Keller: Yes, I am suggesting that they not be depreciated if they are in a state of good repair. The reason for that is it basically encourages people to maintain and invest in their units. Depreciation seems to be somewhat unfair in that situation.

Commissioner Burt: That is acceptable.

Chair Holman: Seconder.

Vice-Chair Garber: Again, if Staff is comfortable with the language I will accept.

Commissioner Keller: There has been issue about how long the life of this thing should be, 59 years, 89 years or whatever. It seems to me that there is actually a different issue. Some people brought up the consideration of how many years it should be based on the life of the building and buildings don’t last that long. It seems to me basing it on a numeric value that is arbitrary doesn’t make as much sense to me as ‘the life of the project.’ So I would suggest that on all new
deeds issued that the restriction be for condo complexes the life of the project and for duplexes
or fee simple properties it would be in perpetuity.

Chair Holman: Pat.

Commissioner Burt: Commissioner Tuma might have a comment that might help us digest that
recommendation.

Commissioner Tuma: It is often the practice in this town and other where people do a
"renovation" which is virtually a ground up rebuild. So is that defined as the project’s life
having ended or not? I am not sure you could deal with that. The end of life of a project is a bit
difficult and amorphous to define. I am sympathetic with what you are struggling with I am just
not sure the end of life of a project is the right way to define that given how people get around
those types of things.

Chair Holman: Commissioner Garber.

Vice-Chair Garber: I think that maybe there are possibly two issues here. One is a legal
definition of the life versus the durability of the physical element being the house or the condo or
duplex, etc. If that is in fact getting at some of your concerns perhaps the issue is more at the
developer of the project build a durable project that can last.

Commissioner Burt: Let me try another crack at moving this forward again. Once again
Commissioner Keller has some insightful ideas about the time where many of our brain cells are
going to sleep. So what if we were to include a motion similar to what Commissioner Tuma was
talking about earlier that all existing homeowners get to continue with their 59 year term and
then future ones would be 89 and once again request that Staff evaluate the potential merits of
Commissioner Keller's alternative and if Staff finds that to be better then they are welcome to
make that recommendation to Council at the time that it goes to Council.

Mr. Williams: We could do it like that. I was also going to say the ordinance is going to come
back to you and it is part of that. So as part of that we could bring it back with what our thoughts
are on other ways to approach that.

Commissioner Burt: Okay. Is that acceptable, Arthur?

Commissioner Keller: Yes it is and I have one more.

Chair Holman: We need to hear from the seconder, Commissioner Garber.

Vice-Chair Garber: Accepted.

Chair Holman: Can I add one little piece to that to go along Commissioner Tuma’s comments
there is a definition for demolition so life of the project, 50 percent is the definition of demolition
and people do try to skirt that nevertheless. Commissioner Keller.
Commissioner Keller: The last thing that I want to add is that when the ordinance is drafted that Staff consider prioritizing the order of the lists based on criteria such as whether the person on the list is an employee of the City of Palo Alto or an employee of Palo Alto Unified School District and that those people be given priority in the list, and that priority be used for what order people are chosen.

Commissioner Burt: My response to that, I had given some thought to it earlier and it is something I have long been interested in pursuing, is that we have a lot of people who have needs for housing in this community including those that are in private sector that we value and those that are in public sector that wouldn’t qualify under those. We have people tonight who were daycare workers we are not city employees, people who might work for county social services who are not city employees. The merit of them getting extra points for qualification may be just as deserving as many others with the exception that I can see in the community, I really want us to pursue these additional opportunities and scoring system for public service workers that we really want to give every opportunity possible to live near the community and especially emergency service workers. So I think I would like once again to put that in the category of requesting that Staff evaluate what tools might be explored in the future or utilized in the future to give additional point systems for members of our community who are public workers fulfilling vital needs without attempting to prescribe that.

Ms. Caporgno: I just wanted to add one thing. We would be glad to bring that back to you. We also can bring back some information regarding some estimates of how many would qualify because I think one of the problems is teachers and probably emergency service workers, and I am assuming you mean police and fire particularly, a lot of their salaries will be outside the realm of the moderate income level particular if there is more than one working person in the household. I think the entry-level teachers may qualify but for a very short period of time. We will be glad to bring that information back to you.

Commissioner Burt: Arthur, if that is acceptable?

Commissioner Keller: Yes, that is fine. I would also consider that we include people who are utility workers because in the event of a major disaster we want our utilities working as well.

Commissioner Burt: Agreed. That is part of what makes this a complex issue. Dan, are you okay with Staff exploring this concept?

Vice-Chair Garber: Yes I am. I am somewhat hesitant to identify specific types of people, classes is easier for me to accept but I think the language in that we are allowing Staff to explore different ways of dividing the pie here. I am happy for that exploration to occur to see if it is a valid way or to make distinctions between these classes of people. Thank you.

Commissioner Burt: My modifying language in the motion was deliberately broad and discretionary for Staff’s exploration of the concept.

Chair Holman: Commissioner Tuma and then Commissioner Lippert.
Commissioner Tuma: With Arthur the Amender having taken most of the amendments I had in mind I will offer simply just one additional amendment. As this goes to Council Staff makes a recommendation on periodic reviews of key financial levers that should be looked at in order to keep the program operating the way it was intended to.

Commissioner Burt: Agreed.

Vice-Chair Garber: Yes, accepted.

Chair Holman: Commissioner Lippert.

Commissioner Lippert: I have nothing to add.

Chair Holman: Commissioner Sandas?

I have just a couple. One is that I mentioned earlier that 2A be amended because for me this is critical. That 2A be amended it has to do with substituting smaller units only if the BMR units are provided by the developer, ‘as long as a comparable square footage is provided.’ I know that may be more detail than Staff wants to hear right now but that is what makes this a go or not for me. So if the maker of the motion would accept that?

Commissioner Burt: Could you clarify that one more time?

Chair Holman: Yes. Right now it reads that a developer could provide smaller units.

Commissioner Burt: Yes, I understand now. They can provide more units provided that they retain the square footage that would have been required by the stipulated number of comparable units.

Chair Holman: Yes.

Commissioner Burt: That is acceptable to me.

Chair Holman: Seconder?

Vice-Chair Garber: I apologize can you restate your amendment? Accepted.

Chair Holman: The only other one that I had is for in lieu fees for fractional units that Staff explore reducing the number of units from 30. I don’t want to set a target on that but right now the developer can pay an in lieu fee for fractional units if the development is 30 units or more unless there is a size tripped. I would like for that number to be explored as to whether it could be lower than 30.

Commissioner Burt: That is acceptable.

Vice-Chair Garber: That is fine.
Chair Holman: Thank you for those.

Commissioner Burt: Does Staff need me to restate the amendments or do you guys have them and want to restate them?

Mr. Williams: I think we have 11 so I think we have them all.

Commissioner Burt: That is more than I have so you probably have a better list.

Chair Holman: Okay.

Mr. Williams: I included the first three on the recommendation piece. It is probably eight.

Commissioner Burt: Okay.

MOTION PASSED (7-0-0-0)

Chair Holman: Okay. I want to thank members of the public for coming and I do wonder as we have had this discussion this evening I do wonder how this discussion may have been different if there were people who are on the waiting list had been here in addition to people who are currently in BMR units. We won’t know. Given that we will call the question.

All those in favor of the motion say aye. (ayes) Opposed? None. So that motion passes on a seven to zero vote. Thank you all. Thank you to members of the public for your participation.

Commissioner Burt: Karen, could you perhaps review for members of the public or maybe Staff could procedurally what will happen now? We don’t get to make decisions we make recommendations here.

Ms. Caporgno: What is next scheduled is we are anticipating taking this to the Council in probably November. Then the Council will then have to direct us to go back and modify the Housing Element and also then to create the BMR ordinance. Then will then come back to you for review for changes to the Housing Element and before it is adopted by Council. Then the BMR will probably come to you in early 2008. This is of course if the Council goes along with what we are all proposing.

Commissioner Burt: Maybe the Chair can allow you to speak with Staff directly and they can do that.

Chair Holman: You would need to speak with Staff at this point because the public comment period is closed. Commissioner Keller, did you have a comment to make?

Commissioner Keller: Yes, I would just like to say on the record that I appreciate that the Council’s Policy and Services Committee referred this to us for analysis and I appreciate that they have done that. They didn’t have to and I just want to put that on the record.
Description of Home Maintenance and Replacements Credit

[Staff Proposed Alternative to Retroactive Change to Full CPI Appreciation Formula]

Objectives of Credit:

- Provide a financial incentive (at resale time) to BMR owners who perform regular upkeep, repairs, maintenance, and install replacement equipment on a regular basis.

- Tie the maximum amount of the incentive to the number of years the owner has been under the one-third CPI appreciation formula to help compensate for the low rate of appreciation under that formula.

- Allocate estimated costs to remedy any deferred maintenance and to make a unit ready to sell to the time period the current seller has been the owner, so sellers are not responsible for the condition of the unit when they purchased it, if it was in inadequate condition at that time.

- Meant to help sellers recover the expense of relatively minor improvements (such as a new light fixture) and the value of the owner’s labor if they do repairs themselves

- Supplements current policy on the treatment of major capital improvements, but those rules will also be simplified.

Specific Description:

- $1,500 credit per year for each full year of ownership by the current selling owner during which the BMR unit was under the one-third CPI appreciation formula to be added to the resale price, provided that the unit is in:
  - Good condition: neat, clean and ready to sell
  - Equipment and fixtures (such as carpets, flooring, appliances, furnace, water heaters, etc) must function well and not be well past their normal useful life

- $36,000 is the current maximum amount of the Credit because 24 years is the presently the longest time that a BMR unit has been under the one-third of CPI formula

  - Example: The one-third of CPI formula became effective in November 1983, which was just over 24 years ago. 24 years times $1,500 = $36,000

- Sellers will continue to be responsible (prior to close of escrow) for:
  - Completing any needed repairs, including those shown on the pest inspection report
  - Cleaning unit after moving out, including carpet shampooing
  - Touching up paint or re-painting, as needed
  - Replacing broken appliances or those well past their useful life
• Receipts for maintenance expenses or replacement costs are not required in order to qualify for the Credit, but staff will check each unit to evaluate its condition.

• **Substantial Capital Improvements**: City will continue to add to the resale price the documented depreciated value of substantial capital improvements as specified under the existing deed restrictions **in addition to any Credit** the seller is eligible for.

• **Units in Substandard Condition at Resale**: Despite the incentive of the Credit, some BMR units will be offered for resale in poor condition. Some owners are unable to complete or pay for maintenance or repairs, often due to the owner’s age, disability or financial situation. In these cases, staff will review the unit’s condition and estimate the cost of bringing the unit up to the standards for condition described above. The Credit will be calculated and the estimated cost of needed repairs, deferred maintenance and necessary replacements of equipment will be deducted and held in escrow to reimburse the buyer. The buyer will need to have the work completed immediately after purchase of the unit. Once the work is done, the City will authorize escrow to release the funds to the buyer.

**Example #1**: A 24 year old, one-bedroom BMR unit sold brand new in 1983 with one-third CPI appreciation formula. It is being resold by the original owner for the first time in 2008. Seller has carefully maintained the unit and replaced appliances if they broke or when they became old. The carpets were replaced 5 years ago and are still in good condition and the unit is very clean. $15,000 was spent by owner in 2006 for new kitchen cabinets, sink, counters and flooring. This seller gets the full Credit plus the cost of the recent kitchen remodel.

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>$80,200</td>
<td>Resale price with one-third CPI formula</td>
</tr>
<tr>
<td>$36,000</td>
<td>Home Maintenance Credit (24 yrs x $1,500)</td>
</tr>
<tr>
<td>$15,000</td>
<td>Capital improvements to kitchen (recently done, so no depreciation)</td>
</tr>
<tr>
<td>$131,200</td>
<td>Total Resale Price</td>
</tr>
</tbody>
</table>

*Or $116,200, if no capital improvements were made*

**Example #2**: The unit is in poor condition overall with heavy wear, but it is clean and repairs have been done. Floor coverings, paint, appliances and other equipment are original and thus almost 25 years old. Some appliances are broken and all are well past their normal useful life:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>$80,200</td>
<td>Resale price with one-third CPI formula</td>
</tr>
<tr>
<td>$36,000</td>
<td>Home Maintenance Credit ($1,500 per year for 24 years of ownership under one-third of CPI)</td>
</tr>
<tr>
<td>$116,200</td>
<td>Total Sales Price [$80,200 + $36,000]</td>
</tr>
<tr>
<td>$92,700</td>
<td>Net Sales Price to Seller [$80,200 + $12,500 ($36,000 less the $23,500 estimated cost of deferred maintenance, repairs, equipment replacements)]</td>
</tr>
<tr>
<td>$23,500</td>
<td>Funds Held in Escrow for Buyer to Renovate Unit</td>
</tr>
</tbody>
</table>
**Example #3:** Same 24 year old unit, but the current BMR owner has only owned the unit for 10 years during which time no capital improvements or any replacements have been done. When the unit was purchased 10 years ago; it had never been renovated and had the original appliances & other equipment; the only work done prior to purchase was a fresh coat of paint and new carpeting. This seller is responsible only for his/her prorated share of the $23,500 renovation costs, which is 42% based on his/her period of ownership out of the total age of the unit.

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>$80,200</td>
<td>Resale price calculated with one-third CPI formula</td>
</tr>
<tr>
<td>$15,000</td>
<td>Home Maintenance Credit ($1,500 per year for 10 years of ownership under one-third of CPI)</td>
</tr>
<tr>
<td>($9,870)</td>
<td>Sellers estimated (42%) share of total cost of $23,500 deferred maintenance, repairs, and equipment replacements</td>
</tr>
<tr>
<td>$13,630</td>
<td>Increase to New Buyers Sales Price to Cover Remainder of Renovation</td>
</tr>
<tr>
<td>$108,830</td>
<td>Total Sales Price for New Buyer [$80,200 + $15,000 + $13,630]</td>
</tr>
<tr>
<td>$85,330</td>
<td>Net Sales Proceeds to Seller [$80,200 + $15,000 - $9,870]</td>
</tr>
<tr>
<td>$23,500</td>
<td>Funds Held in Escrow for Buyer to Renovate Unit [$9,870 + $13,630]</td>
</tr>
</tbody>
</table>