<table>
<thead>
<tr>
<th>Sample 3 Bedroom BMR Unit Originally Sold New in 1987 then Resold in 2007</th>
<th>Original Purchase Price in 1987</th>
<th>Resale Price with One-Third CPI Only</th>
<th>Resale Price with One-Third CPI &amp; Full Credit of $2,000 Per Year for 20 Years</th>
<th>Resale Price with Full CPI without Credit</th>
<th>Resale Price with 70% of AMI without Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$115,000</td>
<td>$148,500</td>
<td>$188,500</td>
<td>$215,300</td>
<td>$231,500</td>
<td></td>
</tr>
</tbody>
</table>

Current Price for Newly Built, 3-Bedroom BMR Units (as of May 2008): $272,700
September 9, 2008

Policy and Services Committee
City Council of Palo Alto
250 Hamilton Avenue
Palo Alto, CA 94301

RE: Below Market Rate (BMR) Appreciation Formula

Dear Committee Members:

The Palo Alto Housing Corporation (PAHC), through its affiliate, Palo Alto Housing Services LLC, has administered the City of Palo Alto’s Below Market Rate (BMR) Housing Program since 1975. The City of Palo Alto was early to adopt inclusionary zoning and we have had over thirty years of experience with both the positive and difficult issues inherent in the program. The primary policy underpinning of the BMR ownership program is to provide an affordable homeownership program, not an equity-building program. Very early on, there was some thought that BMR units might be a stepping stone to market rate housing, but that has not been true since the price escalations of the 70s and 80s.

The other basic principle is that the resale price for BMR units should stay affordable over time and not escalate so that only a small range of moderate-income families can afford them. While other cities have made different choices and allow a windfall to one family to sell a BMR unit at market rate after only thirty years of restriction, the City of Palo Alto has always stood firm with its policy choice of keeping BMR units at much longer terms of affordability (currently at 59 years). We want to continue to emphasize the importance of affordability over time. We believe that the choices that have been made by Palo Alto are proper and sustain the BMR program as an affordable housing ownership program.

In 2007, the Board of Directors of the Palo Alto Housing Corporation (PAHC Board) recommended to the City Council to increase the appreciation formula used in determining the resale price from one-third Consumer Price Index (CPI) to 100% CPI. Even at that time, however, the PAHC Board had some concerns about increasing the formula to 100% CPI, fearing a repeat of the price escalations of the 80s. We made our recommendation to 100% CPI prior to the Council’s recent adoption this spring of the $2,000 per year Home Maintenance and Replacement Credit Program.

Since this policy change, the PAHC Board has revisited its initial recommendation in light of the $2,000 per year incentive credit. The PAHC Board now recommends to the City Council that the formula for establishing the resale price for units in the Below Market Rate Ownership program be based on the current one-third CPI, in conjunction with the Council’s recently adopted $2,000 per year Home Maintenance and Replacement Credit Program.
We believe that this recommendation supports the primary goal of the program which is to sustain affordability over time. It also supports the goal that the appreciation formula is easy to understand and to administer. Maintaining the current appreciation formula of one-third CPI (plus the $2,000 per year maintenance credit incentive) would involve no changes from the City, no retroactivity issues, and no other deed revisions.

The PAHC Board strongly supports the Home Maintenance and Replacement Credit. We believe this policy provides a good incentive to homeowners to maintain their homes and increase salability at resale, while also providing a reasonable return when coupled with the one-third CPI formula. Moreover, this policy change does not need to be written into the deed restrictions and can be adjusted by the Council in the future, based on evidence that it is either too low or too high to achieve the dual goals of providing an incentive to maintain the units and to protect long-term affordability.

In reaching its revised recommendation, the PAHC Board examined evidence presented in the July 7, 2008 CMR on the effect on the sales price of older BMR units, based on both the Area Median Income (AMI) and full CPI formulas, when calculated in conjunction with the $2,000 annual credit. Per the attached comparisons, it is clear that a formula based on 100% CPI formula will have the effect of making older units, which are in “ready to sell condition” (and therefore eligible for the $2,000 per year incentive program) but not necessarily modern condition, nearly equal in sales price to completely brand new units with new appliances, new carpets, etc.. This will not only affect the salability of these older units, but will also eventually move the unit prices out of the affordability range for moderate income families. The same holds true for any formula based on AMI. Additionally, the Staff’s 80% of AMI formula is excessively complicated in comparison to the current formula and not easily explained, calculated or administered.

Therefore, the PAHC Board no longer supports 100% CPI when coupled with the $2,000 annual incentive credit. The PAHC Board also continues to strongly oppose the AMI formula approach as it meets neither of the key goals for the BMR program: affordability in the long term for moderate income families and ease of administration. Please see Attachment A for a sample comparison of unit appreciation using the different formulas referenced in this letter.

We urge the Policy and Services Committee to recommend to the City Council to maintain the current one-third CPI formula, in conjunction with the $2,000 per year maintenance credit incentive. This should improve the BMR ownership program and address appreciation concerns without compromising and undermining the basic intent of the program.

Thank you for your consideration.

Sincerely,

Palo Alto Housing Corporation
BOARD OF DIRECTORS

Bonnie Packer,
President
### Attachment A: BMR Appreciation Formula

#### Example 1: BMR Resale Unit: Ashby Duplex; 3-Bedroom/2-Bath; 1,520 sq. ft.

<table>
<thead>
<tr>
<th>Price Paid by Current Owner in August 1985</th>
<th>Capital Improvements</th>
<th>Resale Price w/1/3 CPI Appreciation During Ownership</th>
<th>Maintenance &amp; Replacements Credit ($2,000 x 23 yrs)</th>
<th>Current Sale Price using 1/3 CPI &amp; Credit(^1)</th>
<th>Approximate Sale Price using 100% CPI(^2)</th>
<th>Approximate Sale Price using 80% AMI(^3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$102,900</td>
<td>$3,430</td>
<td>$139,470</td>
<td>$46,000</td>
<td>$188,900(^1)</td>
<td>$215,630(^2)</td>
<td>$188,720(^3)</td>
</tr>
</tbody>
</table>

Note: New 3-Bedroom comparably sized BMR unit average sale price is $275,850

#### Example 2: BMR Resale Unit at Villa de San Alma; 1-Bedroom/1-Bath; 750 sq. ft.

<table>
<thead>
<tr>
<th>Price Paid by Current Owner in April 1990</th>
<th>Capital Improvements</th>
<th>Resale Price w/1/3 CPI Appreciation During Ownership</th>
<th>Maintenance &amp; Replacements Credit ($2,000 x 18 yrs)</th>
<th>Current Sale Price using 1/3 CPI &amp; Credit(^1)</th>
<th>Approximate Sale Price using 100% CPI(^2)</th>
<th>Approximate Sale Price using 80% AMI(^3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$63,700</td>
<td>$15,350</td>
<td>$79,150</td>
<td>$36,000</td>
<td>$130,500(^1)</td>
<td>$125,150(^2)</td>
<td>$107,424(^3)</td>
</tr>
</tbody>
</table>

Note: New 1-Bedroom comparably sized BMR unit average sale price is $208,600

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\(^1\) PAHC Board of Director’s recommendation to maintain current 1/3 CPI based appreciation formula with the Credit

\(^2\) 100% CPI based appreciation formula (Credit not available)

\(^3\) City Staff recommendation of 80% AMI based appreciation formula (Credit not available)
Chairperson Kishimoto called the Policy and Services Committee meeting to order at 7:02 p.m. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Barton, Drekmeier, Kishimoto (chair), Espinosa

Absent: None

1. Oral Communications

None.

2. Recommendation to City Council for Approval of a Pilot Program Involving “Open City Hall” Online Services

Interim Deputy City Manager Kelly Morariu introduced Peak Democracy representatives Robert Vogel and Michael Cohen and reviewed a brief history of the Peak Democracy program. She asked the Committee for outreach ideas that reached above and beyond the usual arenas. She explained staff’s recommendation was a proposed six month pilot program being hosted and monitored by Peak Democracy on their website, www.OpenCityHall.com.

Peak Democracy representative, Robert Vogel reviewed a presentation of their services available to the City. He stated the service was created to give the community an opportunity to participate in community and neighborhood meetings without fear of being interpreted as a complainer or not receiving the response they were interested in. He displayed an on-line demonstration of the website.

Council Member Barton asked whether there was a location on the website where the consumer could locate City information linked to the item being viewed.

Mr. Vogel stated yes. The pages of the site could be modified to suit the controller’s desired result. He stated although the community participant had the opportunity to leave a comment anonymously they must be registered with the site to be able to make the comment.
Chair Kishimoto asked whether there was confirmation a check on the validity of the registrant once they register on the site.

Mr. Vogel stated yes. Although, there were no fool proof way of verifying all information it is a secure site.

Management Fellow Sherilyn Tran asked whether the community had the ability to adjust what they had written at later time.

Mr. Vogel stated yes. Although each time the comment was modified that statement remained in the original location.

City Manager James Keene asked whether the parameters were able to be redefined.

Mr. Vogel stated yes.

Chair Kishimoto asked whether the advanced search section had the ability to adjust the different ranges of the search criteria.

Mr. Vogel stated yes.

Ms. Morariu asked whether the City had the ability to control the options available on the site. Since the site was not hosted on a City site she asked how changes would be made.

Mr. Vogel stated yes, the City had the ability to enable the site abilities. However, the City needed to inform them as to what changes were desired and the company would perform said changes.

Chair Kishimoto asked if the website service posted meeting responses the next day.

Mr. Vogel stated yes.

Vice Mayor Drekmeyer expressed as part of the service whether the company read all of the comments. He asked whether the company was prepared for the large numbers of participants there could be with our community.

Mr. Vogel stated the company had worked with other Cities with large community involvement.

Vice Mayor Drekmeyer asked how to prevent fraudulent participation.
Mr. Vogel stated there were systems checks on the system to prevent a large amount of fraudulent activity. There were limitations to all security systems although all addresses were checked back to an IP address, e-mail addresses were validated, and cookies were required on the browser.

Vice Mayor Drekmeier asked whether they could determine whether a library computer was used.

Mr. Vogel stated it was possible however not necessarily with a great deal of validity.

Vice Mayor Drekmeier asked whether the Council was expected to review the website prior to the meeting to review the comments.

Mr. Vogel stated the site was generated to assist the Council in knowing the community and what they were thinking regarding the issues at hand. The site had the ability to print reports for review.

Ms. Morariu stated there would be a policy in place to close the forum at noon and the City Clerk’s Office would print the communications and distribute them to Council at the Meeting.

Vice Mayor Drekmeier asked the cost to continue the service after the pilot program.

Mr. Vogel stated the breakdown was an initial five thousand dollar setup fee plus a monthly cost of 200 dollars. The pilot program included the set-up fee and the first six months. Therefore the cost would remain at 200 dollars per month at the current service level.

Council Member Espinosa stated concern for the website not being hosted by the City website.

City Manager James Keene stated the City website concerns have been reviewed and changes were being made for the future.

Council Member Barton stated having the off-site hosting had value to the community by a non-partisan view. He suggested the items being discussed on the forum be non-Consent items.

Council Member Espinosa asked how the system responded to questions asked on the website.

Mr. Vogel stated the end-user did not have the concept that there would be a
response. The system was designed for the community to share their views and opinions with each other and the Council. There was a forum announcement section where a response could be placed if so desired.

Council Member Barton suggested Palo Alto On-Line as an outreach venue. He mentioned at present time a judgment of success would be premature, he suggested waiting until after the pilot program had ended to discuss success or options for change.

Mr. Vogel stated the number of items posted was up to the controller; however he suggested starting out with the most interesting items and build to all of them. He recommended all agenda items be posted in the future with a smaller number in the beginning focusing on the larger items of concern.

Mr. Keene asked whether with the span of the pilot program the City would have the opportunity to expand to the full agenda.

Mr. Vogel stated the value of the program could only be determined by the City. He stated a survey could be placed in the program for end-users to report their thoughts of whether the program was successful in their views.

Vice Mayor Drekmeier asked for an estimation of staff time that would be required to run the program.

Ms. Morariu stated the volume was unknown at the moment although the City Managers Department would be drafting the questions from the staff reports, the City Clerk’s Office would be printing and preparing the forum comments, the print shop may be impacted, and the IT Department would be involved initially.

Mr. Keen stated outside of the print time, the project does not appear to take a large amount of time.

Peak Democracy representative, Michael Cohen stated ideally the object of Peak Democracy was to be a back-end service provider where we provided the technology and the communities view was they were on the City of Palo Alto website.

Mr. Keene stated through the Alliance of Innovation there were pilot programs initiated and the City could benefit from their experiences. Vice Mayor Drekmeier asked the original cost for the program.

Mr. Vogel stated it was set at 50 dollars per question.
Vice Mayor Drekmeier stated he supported the Motion.

**MOTION:** Council Member Barton moved, seconded by Chair Kishimoto, that the Policy and Services Committee recommend to the City Council approval of a six month Pilot Program with Peak Democracy involving “Open City Hall” Online Service; that staff choose the most important topics for each Council meeting and return to Policy and Services Committee for an evaluation on whether or not to continue the program. The Council Contingency Fund would fund the program.

**MOTION PASSED 3-1** Espinosa no.

3. Recommendation to City Council Regarding Alternatives for an Area Median Income-Based Resale Price Formula for the Below Market Rate (BMR) Ownership Program.

Cathy Siegel, Advanced Planning Manager, spoke about the staff report presented to Council on July 7, 2008. On July 7 the Council referred the selection of an appreciation formula for new BMR units and resale of existing units to the Policy and Services Committee and directed Staff to develop an appreciation formula based on Area Median Income (AMI). Based on Council’s policy decision the resale prices of BMR Units as they age should be kept at the moderate income level of affordability. At the July 7, 2008 meeting it was brought up that the AMI formula would result in resale units costing approximately the same as new units. This might result in problems over time especially with owners who did capital improvements, or with units receiving major special adjustments from Home Owners Association (HOA’s). The City could end up with units that would be harder to sell and might have prices that exceed new units, and buyers would only want the newer units since they were cheaper. Staff decided that an AMI approach to appreciation using the Kaiser Marsden approach was best, as they have various protections. Staff suggestion is to reduce the AMI percent to 70 percent. The City could then get to a level of appreciation that would put older units sufficiently lower than new units. This would allow the older units to absorb the cost of capital improvements. There may still be units that the City will have to deal with on a case-by-case basis. She stated that Council also directed Staff to work towards establishing a renovation loan program for the lowest income owners who cannot afford to improve and maintain their unit. Staff should have that completed within the next year.

Chairperson Kishimoto asked about the proposed 2 thousand dollar per year credit to owners.

Ms. Siegal stated the annual credit is to reward owners who have done regular
maintenance and kept their units in good shape. It was developed in response to owners under the one-third Consumer Price Index (CPI) formula. Per Council’s direction this annual credit is only applied to owners with the one-third CPI. It was not intended to apply to newer properties that would have a newer more liberal appreciation formula. Staff has implemented the annual credit with the last five house sales. The current sales have been with owners who have maintained their units and they have received the credit.

Chair Kishimoto asked if the depreciated value of capital improvements would be added to the BMR resale price calculation with 70 percent AMI formula.

Ms. Siegal replied yes.

Council Member Espinosa asked how the decision making occurred with the Palo Alto Housing Corporation (PAHC) and Staff. He stated his concern was that PAHC didn’t agree with Staff recommendations.

Ms. Siegal stated that staff has met periodically over the whole BMR study with PAHC and the BMR Committee.

Curtis Williams, Acting Director of Planning and Community Environment, stated that Council provided Staff direction to go to the AMI formula similar to what Kaiser Marsden had suggested. Council direction was to adjust the gap to make it safer and more secure, so the City doesn’t end up with units that need improvements. There haven’t been any discussion of this with PAHC since July. PAHC did not agree with AMI formula that was given by Council.

Chair Kishimoto stated there were two or three choices before the Council at that time. The city has a new ABAG mandate to provide very low housing units. The goal should be to provide the most affordable housing for the City investment. She believes the AMI Index is a reasonable index; we could discuss decreasing the level from 80 percent to 70 percent. We should keep prices low, because we have a stock of houses.

Council Member Barton discussed the various proposals and asked what the policy statement would be if we went with the 70 percent over the one third CPI plus the annual bonus credit. What does it mean to choose one over the other as far as a policy statement.
Mr. Williams stated there are two components. The first is that the City values the people who buy into the program and their opportunity to gain appreciation on their unit when they sell. They would get more out of it with the two thousand dollar annual credit. The second policy is to develop a moderate income product that at the end would come in at the low income levels. The City would retain more opportunity to supply to low income families.
Bonnie Packer, representing the BMR Committee, stated we have always worked closely with Staff. She stated they were not directed to look at AMI and that is why they stayed with CPI. The experience we have had of the five homeowners getting the annual credit, these owners are getting a nice return on their investment. It is small investment, with a good return. We have to ensure that the policy is easily understood by all. By using the one-third CPI plus the two thousand dollars per year credit, it makes it easy to understand and a great incentive for the owner to maintain the unit.

Marcie Mitchell, BMR Housing Administrator, stated there are three current resale units that we have applied the two thousand dollar maintenance replacement credit to, and they were under the one-third CPI program. The owners are pleased with the return on their investment. She stated her concern is the price of the units, as proposed by the AMI figures, there is not enough of a safety net between the resale of older units and the new units. She suggested lowering the proposed 70% AMI or keeping where it is. She stated she would support the current CPI and credit allowance because it makes is easier to administer. There would be no deed restriction changes for the 300 units, and no formula to relearn and try to explain to current and potential homeowners.

Ms. Packer stated the BMR Committee questioned what AMI and CPI are and how these indexes relate to the involved homeowners. Average median income can go up, but the people we are serving are in the low income range and the ups and downs do not affect them. If one is interested in the appreciation then AMI gets you that, but CPI will get you purchasing power.

Chair Kishimoto stated that depending on the time period, sometimes CPI is much higher than AMI.

Council Member Barton asked about the value of having the delta between new and older units. Doesn’t the market smooth that out. Why are we concerned if a newer unit sells for more than an older unit.

Ms. Siegal stated that those people on the waiting list are very interested in new units. We also have current owners who are interested in moving up to new units.

Chair Kishimoto asked if a unit is unattractive, whether the City has to buy it back and pay to upgrade it.

Ms. Siegal stated there have been some older units that were poorly designed that have been more difficult to resell, but Staff has had great success with
most units.

Vice Mayor Drekmeier stated he is having a hard time moving forward with this issue because there are no BMR unit owners here to speak. He wants to ensure that this doesn’t end up coming back to Policy and Services because the owners weren’t here tonight.

Ms. Packer stated that she has spoken about this issue with 12-24 current BMR unit owners and their response has been mostly favorable. She stated approximately 75 percent are in favor of the one-third CPI formula. Two of the three owners in the process of selling now are pleased with the way it is now. PAHC explained the benefits of this formula to the owners and they were pleased with the program and how it benefited them.

Chair Kishimoto asked if PAHC recommends going back to the one-third CPI formula plus the annual two thousand dollar maintenance credit. She also asked if PAHC was against the minimum and maximum ceiling or cap on the amount.

Ms. Mitchell stated PAHC is in favor of the one-third CPI, but against the ceiling approach as it makes the formula too complicated.

Chair Kishimoto stated that using the cap or ceiling approach the house would never be sold for less than what the owner paid for it.

Ms. Mitchell answered yes. She stated that is the current case.

Chair Kishimoto asked who would do the calculations PAHC or staff.

Ms. Siegal stated that PAHC does the calculations to set the sale price; City Staff inspects the units, evaluates the receipts for capital improvements, and evaluates the overall condition of the unit for the annual maintenance credit. The complexity of the formula is a problem with administering the program and staff has to find a way to explain the program and calculations to potential buyers and owners.

Chair Kishimoto asked if there has to be some type of index used.

Ms. Siegal answered yes. CPI is more understandable for people, and information on it is more accessible to the general public. It changes every two. AMI is manipulated by HUD and sent out annually. She stated that communities that have use AMI for BMR programs have experienced problems over the past six years due to its fluctuations.
Council Member Espinosa stated that part of having this come back to us was to think through AMI as an option and if this was the right way to go. He asked if staff should have waited to bring this back so that all these issues could have been resolved and a more comprehensive solution could have been brought to Policy and Services.

Chair Kishimoto asked if Staff is more comfortable going back to CPI.

Mr. Williams stated that Staff is comfortable going back to CPI. Staff has seen some recent sales where there is a significant dollar difference in favor of the owners.

**MOTION:** Council Member Barton moved, seconded by Chair Kishimoto moved to recommend to the City Council that the BMR appreciation formula return to one-third CPI with the two thousand dollar annual per year credit.

Council Member Espinosa questioned where we are now and where Staff was at beginning of meeting and whether more analysis is needed.

Council Member Barton stated that is a good concern but we asked them to research the AMI approach. Staff did what we asked them to do, and our conversation tonight has made him comfortable with the motion being made.

Chair Kishimoto stated it is not just the AMI versus CPI issue; it is the difference between the 80 percent or 90 percent of one-third. We are going back to the one-third CPI.

Chair Kishimoto stated that this recommendation lets the prices stay as low as reasonable but give owners some reasonable return. We are not sticking with the interim goal of 80 percent of AMI, and we are going back to the original proposal.

**MOTION PASSED** 4-0.

4. Discussion for Future Meeting Schedules and Agendas

   October 14, 2008
   November 18, 2008

**ADJOURNMENT:** Meeting adjourned at 8:45 p.m.
TO: HONORABLE CITY COUNCIL
FROM: CITY MANAGER
DATE: JULY 7, 2008
SUBJECT: APPROVAL OF AN AREA MEDIAN INCOME-BASED RESALE PRICE FORMULA FOR THE BELOW MARKET RATE OWNERSHIP PROGRAM

RECOMMENDATION
Staff recommends that the City Council approve the resale price formula for appreciation of BMR ownership units based on 80 percent of the percentage change of the area median income as recommended by the BMR Study consultants (Attachment A) to be incorporated into revisions to the BMR Ordinance and/or rules and regulations.

BACKGROUND
At its meeting of March 24, 2008, Council voted (8-0 with Burt absent) to approve recommendations from the Policy and Services Committee, PTC and staff implementing policy changes to the BMR program as described in Attachment E. Council, however, voted to direct staff to return with a resale price formula based on the change in the Santa Clara County Area Median Income (AMI) for the full Consumer Price Index (CPI) resale price formula recommended by the PTC and staff. Council’s specific direction to staff on March 24th was:

“to change going forward to an Area Median Income (AMI) appreciation formula which will be brought back to Council by staff with an analysis and specific recommendations on consent agenda at a later date.”

Council members stated support for an AMI based formula because it would be more likely to provide greater appreciation for BMR owners and also result in resale prices which would maintain the BMR units within the moderate income affordability price range of 80 to 120 percent of AMI, based on the comparative history of the CPI and AMI indices over the last 30 years. A policy of maintaining the units over the long term within the moderate income price range was supported by Council as being more consistent with the original goals of the program than the one-third or the full CPI methods, which have resulted in the units becoming relatively more affordable over time.
DISCUSSION
A modified AMI based resale price formula was recommended by Keyser Marston Associates (KMA) in the BMR Study report (see Attachments A and B). Staff had asked KMA to develop a resale formula that would work well in varying economic cycles and would meet the following criteria, to the extent possible:

- Resale prices should not exceed prices for new BMR units;
- Keep resale prices sufficiently below market prices of similar units;
- Resales price will not be less than the seller’s original purchase price;
- Keep resale prices from dropping far below the moderate income level;
- Provide higher appreciation than the one-third CPI method;
- Encourage better maintenance and capital improvements; and
- Be easy to explain, calculate and administer.

Based on Council’s March 24th direction, staff is recommending that the KMA formula be approved rather than using an unmodified percentage change of the AMI. The KMA proposal is based on 80 percent (or four-fifths) of the percentage increase in the County AMI as published annually by State Housing and Community Development (State HCD). The KMA proposal caps and minimum pricing will help maintain resale prices generally within the moderate income range and provide some cushion for the addition of special assessments and capital improvements onto resale prices without pushing the prices higher than the moderate income level.

Staff believes that caps on BMR resale prices are especially important with an AMI based method given the past history of rapid AMI growth during local economic boom periods. Growth in the median County income does not necessarily equate to a similar growth rate in the household incomes of our waiting list families. Most households interested in Palo Alto BMR ownership, and now on the waiting list, work in occupations where income growth is modest – this is a key reason why they have given up on market rate ownership.

Attachment C illustrates how the AMI has fluctuated as much as ten percent from year to year compared to the lower volatility of the CPI. In the ten years from 1994 – 2003, the AMI increased by 68 percent, but in the last five years, due to changes in HUD’s methodology followed by declining economic factors, the AMI has not increased at all but remained at $105,500. Attachment D provides a detailed retroactive 20-year comparison of the full CPI, the full AMI and the 80 percent of AMI with an example of these formulas applied to a typical three bedroom BMR unit first sold in 1987 and then resold in 2007.

The data from Attachment D is used in the table below to compare resale prices produced by each formula for a sample 20-year old BMR unit being sold in 2008 together with the current pricing for a three bedroom newly constructed BMR unit and the range of affordable prices at today’s interest rates for the typical family sizes that would purchase a three-bedroom BMR unit.
The three formulas produce resale prices that generally fall within the affordability range of 80 to 100 percent of AMI. With the full AMI formula, however, the resale price exceeds the current price for a comparable newly built BMR unit. Most BMR buyers can only manage a five to ten percent downpayment, although there are a few buyers able to make twenty percent or more. The full AMI resale prices would be harder for households at the lower end of the moderate income spectrum to afford without a substantial downpayment. Attachment B illustrates the recommended 80 percent of AMI formula resale price calculation using this same sample unit with the addition of fairly typical adjustments for capital improvements, an assessment and a deduction for some deferred maintenance.

**Full CPI Formula Comparison:** Based on past history, compared to the two AMI-based formulas, the full CPI formula is likely to result in units becoming more affordable than newly built units over the long term. Lower resale prices provide more cushion to help absorb the addition of special assessments, renovation costs and legal costs to preserve units faced with foreclosure and still result in a final resale price that’s within the lower end of the moderate income affordability level. The addition of large special assessments (such as those that occurred at the Redwoods and Abitare) and/or credits for capital improvements to higher AMI based resale prices may result in resale prices that exceed what buyers on the waiting list are willing, or able, to pay, especially as resale units age. The combination of this concern, together with the AMI’s unpredictability and Palo Alto Housing Corporation’s concerns about the complexity of the formula and higher resale prices was what led staff to recommend to Council that the resale formula simply be increased to the full CPI. In addition, at the present time, the full CPI provides current owners under the one-third CPI a financial reward for signing the new, improved deed restrictions, while few owners may want to switch to an AMI formula until regular annual increases in the AMI resume.

**Transition from Current One-Third CPI Formula:** After approval by Council, proposed changes will be incorporated into the ordinance adopting the recommended BMR program changes. As detailed in previous staff reports, these changes will require an overhaul of the City’s deed restrictions, together with the addition of supporting legal documents to assist in both enforcement and clear disclosure of the program’s rules to prospective buyers and owners.
RESOURCES IMPACT
Funds are budgeted in the recently adopted FY 2008-09 budget in the Residential Housing Fund for the cost of contract legal services to prepare new BMR ownership deed restrictions and related enforcement and disclosure documents and to conduct the in-lieu fee study.

POLICY IMPLICATIONS
Council approval of an AMI based resale price formula establishes the policy that the resale pricing method should maintain resale units within the moderate income affordability level over the long term. This policy action, in combination with the approval of the $2,000 annual Maintenance and Replacements Credit for existing BMR units under the one-third of CPI formula on March 24th, clarifies that the City’s goal is that the BMR ownership program is intended to primarily serve moderate income households.

ENVIRONMENTAL REVIEW
The administration of the BMR housing program is categorically exempt under Section 15326 of the California Environmental Quality Act (CEQA).

PREPARED BY: Catherine Siegel
CATHARINE SIEGEL
Advance Planning Manager

DEPARTMENT HEAD REVIEW: Curtis Williams
CURTIS WILLIAMS, Interim Director
Planning and Community Environment

CITY MANAGER APPROVAL: KELLY MORARIU / STEVE EMLSLIE
Deputy City Managers

ATTACHMENTS
A. Resale Price Formula for BMR Unit Based Upon 80 Percent of the Change in the Area Median Income (AMI)
B. BMR Resale Price Calculation With 80% of AMI Formula (Sample Calculation)
C. BMR Study: Comparison of CPI & AMI Chart
D. BMR Study: Appreciation Indexes: 20 year Comparison of Full CPI, Full AMI & 80 % of AMI
E. BMR Program Update: Policy Changes Approved by the City Council on March 24, 2008
F. City Council Special Meeting of March 24, 2008: Excerpt from approved minutes for Item #6 Policy and Services Committee recommendations for approval of updated Below Market Rate (BMR) Program (continued from March 17, 2008)

CMR: 298:08
CC: Palo Alto Housing Corporation, Candice Gonzalez, 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
City of Palo Alto
City Manager's Report

TO: HONORABLE CITY COUNCIL
ATTN: POLICY AND SERVICES COMMITTEE

FROM: CITY MANAGER

DATE: SEPTEMBER 9, 2008

SUBJECT: RECOMMENDATION TO CITY COUNCIL REGARDING ALTERNATIVES FOR AN AREA MEDIAN INCOME-BASED RESALE PRICE FORMULA FOR THE BELOW MARKET RATE OWNERSHIP PROGRAM

RECOMMENDATION
Staff recommends that the Policy and Services Committee review and discuss the two alternatives for a resale price formula for appreciation of BMR ownership units and recommend to the City Council a resale price formula based on 70 percent of the percentage change of the area median income with an overall total resale price limit.

BACKGROUND
At its meeting of July 7, 2008, Council referred the selection of a future BMR resale price formula to the Policy and Services Committee for further discussion and analysis of potential problems that could occur with a formula which results in the resale prices of older BMR units being relatively close to the prices of newly constructed BMR units. Council indicated support for a resale price formula based on 80 percent of the change in the Santa Clara County Area Median Income (AMI) in order to: (1) provide greater appreciation for BMR owners and (2) maintain the BMR units within the moderate income affordability price range; however, this formula could result in resale prices that are close to or even exceed prices for new BMR units especially if the seller is entitled to additional credits to the resale price for capital improvements and / or special condominium assessments. As a result, the Council was concerned that older resale units may become difficult to resell when their prices approach that of new units.

DISCUSSION
Staff has identified a modified AMI-based resale price formula as an alternative to the original consultant proposal. Staff is recommending limiting the appreciation rate to 70 percent of the percentage change in the AMI rather than the 80 percent originally proposed in order to increase the
difference in resale unit prices compared to prices of new units. The 70 percent formula would provide a somewhat greater cushion than the 80 percent formula to absorb the impact of special assessments, capital improvements, or the lower appeal of older units relative to new ones, while still maintaining resale units in the moderate income range of affordability. The table below illustrates the lower appreciation resulting from the 70 percent formula using a typical BMR unit example and the last 20 years history of the change in the AMI.

For further security that all BMR units will be retained in the moderate income affordable housing stock, staff proposes that the formula resale price, including any special assessments and credits for capital improvements, not be allowed to exceed the then current new unit sales price for a comparable category unit. While this provision would prevent resale prices from exceeding moderate income affordability levels due to assessments or high levels of improvements, it could possibly discourage major improvements or limit reimbursement for owners subject to a major assessment.

As directed by Council in 2002, the staff established a deferred payment special assessment loan program for very low income BMR owners and set up the BMR Emergency Fund which funds these loans and other costs related to the preservation of BMR units. While it is likely that some older BMR units will be subject to major special assessments in the future, the current BMR value of most units in the inventory is low enough to absorb such assessments and still remain within the moderate income resale price range. Staff will continue to monitor the BMR housing stock on an ongoing basis and should there be issues in particular complexes with large assessments, then additional housing fund resources may need to be allocated to deal with unusual problems. Another implementation measure from the BMR Study is for staff to develop a loan program for owners to renovate their units. In addition, the new BMR deed restrictions will include clearer and simpler procedures to encourage owners to carry out beneficial capital improvements.

Several of the attachments previously provided with the July 7th staff report have been revised to illustrate the 70% of AMI alternative formula and the historical average annual change with comparison to the 80 percent of AMI. The table below provides a brief comparison of the two formulas.

<table>
<thead>
<tr>
<th>Appreciation Formulas: 20-Year Comparison of Alternative</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Average Annual % Change(^1)</td>
</tr>
<tr>
<td>Average Annual % Change(^1)</td>
</tr>
<tr>
<td>20-Year Increase</td>
</tr>
<tr>
<td>Resale Price of Sample 3-Bedroom Unit(^2)</td>
</tr>
<tr>
<td>Difference from New Unit</td>
</tr>
</tbody>
</table>

Notes:
1 - Time period of 1987 – 2007
2 - Unit originally sold when new 20 years ago for $115,000; no special assessment or capital improvements are added in this example
Staff believes that the 70 percent of AMI formula would provide a reasonable level of protection from resale units being priced too close to new units and, therefore, recommends this alternative. If the Council still has concerns regarding the viability of the AMI-based formula for resale units, the full CPI formula as supported by the PTC could be revisited. A minimum floor on the resale price, as recommended for the AMI-based formula, could also be added to ensure resale units prices do not drop into the very low income range.

**RESOURCE IMPACT**

Limiting the appreciation of BMR unit resale prices should preserve the City’s housing funds by reducing the likelihood of the City having to buy down the resale price of units in order to keep them within a price range that is attractive to prospective qualified BMR buyers. Limiting the appreciation however, could discourage good maintenance, repairs and needed capital improvements and can also have a resource impact on City housing funds, if the City should have to provide loans or grants to bring units into an acceptable condition.

**POLICY IMPLICATIONS**

Selection of a resale price formula targeted for moderate income levels reinforces the objectives for the BMR ownership program intended to provide affordable housing for moderate income level households. Although keeping resale units within the moderate income affordability level may result in some older units that are more difficult to sell, there is no method that will work in all economic scenarios and achieve all of the City’s housing program objectives.

**ENVIRONMENTAL REVIEW**

The administration of the BMR housing program is categorically exempt under Section 15326 of the California Environmental Quality Act (CEQA).

**PREPARED BY:**

Catherine Siegel  
CATHERINE SIEGEL  
Advance Planning Manager

**DEPARTMENT HEAD REVIEW:**

Curtis Williams  
CURTIS WILLIAMS  
Interim Director of Planning and Community Environment

**CITY MANAGER APPROVAL:**

James Keene  
City Manager
ATTACHMENTS
A. Resale Price Formula for BMR Unit Based Upon 70 Percent of the Change in the Area Median Income (AMI)
B. BMR Resale Price Calculation With 70% of AMI Formula (Sample Calculation)
C. BMR Study: Appreciation Indexes: 20 year Comparison of Full CPI, Full AMI, 80 % of AMI, and 70% of AMI
D. City Managers Report 298:08 of July 7, 2008 (City Council only)

CC: Palo Alto Housing Corporation, Candice Gonzalez, 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
    Home Builders Association of Northern California, Southern Division
Resale Price Formula for BMR Unit Based Upon 70 Percent of the Change in the Area Median Income (AMI)
Below Market Rate (BMR) Home Ownership Program
Revised: September 2008

The resale price formula is driven by a “base” appreciation index equal to 70% of the percentage increase in the AMI, with upper and lower limits on the resale price¹, as follows:

1) The “Base” appreciation index is equal to 70% of the percentage increase in the AMI over the seller’s period of ownership

2) Subject to the Following Price Ceiling:

   Resale Price Ceiling: The resale price cannot exceed the lesser of:

   (a) The then-current new sales prices of comparable BMR units (by number of bedrooms and unit’s original income category)²; and

   (b) 80% of the unrestricted market rate appraised value of the unit

3) Subject to the Following Price Floor:

   Resale Price Floor: The resale price will not be less than the greater of:

   (a) The original purchase price paid by the seller; and

   (b) A price affordable (at time of sale) to households at 75% of AMI (for the low moderate category units); or at 95% of AMI (for the high moderate category units)

4) To the price derived from the above calculations, the follow adjustments are made in order to determine the final sales price (however in no case shall the total resale price exceed the price ceiling in 2 (a) above):

   Plus:

   a) The depreciated value of capital improvements; and

   b) The cost of mandatory special assessments levied by the homeowners association

   Less:

   a) The cost of curing deferred maintenance and repairs

Notes:
¹ This is a modification of the formula recommended by Keyser Marston Associates in the BMR Study, March 2007 (Chapter 3.2, pages 3-16 to 3-25)
² For example, a resale 3-bedroom townhome’s maximum price would equal the current year’s maximum price for new 3-bedroom BMR units
### BMR Resale Price Calculation with 70% of AMI Formula

#### Sample Calculation Using 1987 - 2008 Data

<table>
<thead>
<tr>
<th>Calculation Date: June, 2008</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Address &amp; Description of Unit:</td>
<td>3 Bedroom Lower Moderate Unit</td>
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<tr>
<td>Years Unit Owned:</td>
<td>21</td>
</tr>
<tr>
<td>Factor for Calculation</td>
<td>70%</td>
</tr>
<tr>
<td>Purchase Price When New</td>
<td>$115,000</td>
</tr>
<tr>
<td>Purchase Date</td>
<td>June 1987</td>
</tr>
<tr>
<td>Month &amp; Year of AMI Used</td>
<td>June 2008</td>
</tr>
<tr>
<td>AMI Index at Purchase Date</td>
<td>$43,100</td>
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<tr>
<td>AMI Index at Sales Date</td>
<td>$105,500</td>
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<tr>
<td>Change in Index</td>
<td>$62,400</td>
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<tr>
<td>Total Percent Change in Index Over Time Owned</td>
<td>144.78%</td>
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<tr>
<td>Modifier</td>
<td>2.0135</td>
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<tr>
<td>BMR Calculated Value</td>
<td>$231,553</td>
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<tr>
<td>Appreciation</td>
<td>$116,600</td>
</tr>
<tr>
<td>Resale Price with 70% AMI (Rounded)</td>
<td>$231,600</td>
</tr>
</tbody>
</table>

1) **Caps (Maximum Price): the Lesser of:**

a) Then Current **New Unit Sales Price** at Lower Moderate Income (based on 90% AMI); or $272,700

b) 80% of Unrestricted Fair Market Value ($800,000) $640,000

2) **Floors (Minimum Price): the Greater of:**

a) Original Price Paid by Seller; or $115,000

b) Then Current Affordable Price at 75% of AMI (for Similar Unit) $217,200

Resale Price (after Caps & Floor Adjustments) $231,600

Add: Depreciated Value of Capital Improvements $12,500

Add: Special Assessments by HOA $1,200

Deduct: Cost to cure deferred maintenance, repairs, cleaning, painting, etc; ($800)

**TOTAL ADJUSTED FINAL SALES PRICE** *(But in No Case Can the Resale Price Exceed the Current New Unit Price - see 1a)* $244,500
## ATTACHMENT C

### BMR Study: Appreciation Indexes: 20 Year Comparison of Full CPI, Full AMI & KMA's 80% of AMI (1987-2007)

<table>
<thead>
<tr>
<th>Year #</th>
<th>Year</th>
<th>Full CPI</th>
<th>Full AMI</th>
<th>KMA: 80% of AMI</th>
<th>Staff: 70% of AMI</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>CPI Index Value</td>
<td>CPI Percent Change Over Prior Year</td>
<td>Year CPI Increase (compounded)</td>
<td>County Area Median Income</td>
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<tr>
<td>--</td>
<td>1987</td>
<td>115.4</td>
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<td>$43,100</td>
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<tr>
<td>1</td>
<td>1988</td>
<td>120.5</td>
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<td>1990</td>
<td>132.1</td>
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<td>1991</td>
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<tr>
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<td>142.5</td>
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<td>1993</td>
<td>146.3</td>
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<tr>
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<td>148.7</td>
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<td>151.6</td>
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<tr>
<td>9</td>
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<td>155.1</td>
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<td>1997</td>
<td>160.4</td>
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<tr>
<td>11</td>
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<td>165.5</td>
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<td>1999</td>
<td>172.5</td>
<td>4.2%</td>
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<td>$82,600</td>
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<tr>
<td>13</td>
<td>2000</td>
<td>180.2</td>
<td>4.5%</td>
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<td>$87,000</td>
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<tr>
<td>14</td>
<td>2001</td>
<td>189.9</td>
<td>5.4%</td>
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<td>$87,300</td>
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<tr>
<td>15</td>
<td>2002</td>
<td>193.0</td>
<td>1.6%</td>
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<td>$96,000</td>
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<tr>
<td>16</td>
<td>2003</td>
<td>196.4</td>
<td>1.8%</td>
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<td>$105,500</td>
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<td>2004</td>
<td>198.8</td>
<td>1.2%</td>
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<td>$105,500</td>
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<td>18</td>
<td>2005</td>
<td>202.7</td>
<td>2.0%</td>
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<td>$105,500</td>
</tr>
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<td>19</td>
<td>2006</td>
<td>209.2</td>
<td>3.2%</td>
<td></td>
<td>$105,500</td>
</tr>
<tr>
<td>20</td>
<td>2007</td>
<td>216.048</td>
<td>3.3%</td>
<td></td>
<td>$105,500</td>
</tr>
</tbody>
</table>

|    |     |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |      |
|----|----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
|    |    |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |

### Average Annual Percentage Change Over Last 20 Years

- **Full CPI:** 3.2%
- **Full AMI:** 4.6%
- **KMA 80% of AMI:** 3.7%
- **70% of AMI:** 3.3%

### Resale Price Comparison

**Original Price**

- $115,000

**Full CPI Resale Price**

- $215,300

**Full AMI Resale Price**

- $281,500

**80% of AMI Resale Price**

- $248,200

**70% of AMI Resale Price**

- $231,500

**Cap:**

- Current 3 BR New Price: $272,700