

June 15, 2006

Mr. Barry Rosenbaum, Esq.,
Senior Land Use Attorney
Office of the City Attorney
City of Santa Monica
2121 Cloverfield Blvd., Suite 100
Santa Monica, CA 90405

Re: FY 2006-07 Annual Adjustment for the Affordable Housing Unit Base Fee

Dear Mr. Rosenbaum:

This letter summarizes the annual adjustment calculation methodology that will be utilized by the City to establish the Affordable Housing Unit Base Fee pursuant to Santa Monica Municipal Code Section 9.56.070(b). This methodology was recommended by HR&A in a letter to City staff dated April 24, 2005, and approved by the Santa Monica City Council at a public hearing on June 13, 2006.

Consistent with SMMC Section 9.56.070(b), the calculation approach measures annual changes in land cost and construction costs, which together account for about 75-80 percent of the cost of new affordable housing development.¹ For the construction cost inflation component of the calculation approach, the City Council accepted HR&A's recommendation to use the Engineering News Record's (ENR) Construction Cost Index, because it is updated monthly and is readily available via the Internet. Although there is no comparable index for inflation in land cost, the City Council also accepted our recommendation to use median condominium purchase prices as a proxy measure for land cost changes. Further, since the median condo sale price for the City as a whole would be skewed by the tendency for sales to be concentrated in a few subareas, a more neutral weighted average annual change in median condo sale prices by ZIP Code is used in the calculation approach. These median condo price by City ZIP code data are published by the Los Angeles *Times* each January, using Los Angeles County Assessor data compiled by Dataquick. They are also available on a subscription basis from other vendors, such as First American Real Estate Solutions.

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

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

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

Table 1 below presents the annual adjustment calculation establishing the Affordable Housing Unit Base Fee for FY 2006-07. It shows that a weighted average inflation index using this City Council-approved approach results in a 7.9 percent annual increase, compared with a 5.2 percent increase based on construction costs alone, or 5.1 percent based on the Consumer Price Index (CPI).

It is my understanding that the results of the attached calculation will be the basis for a Resolution increasing the Affordable Housing Fee to the new amounts resulting from the calculations presented in Table 1. We are available to assist you in presenting the Resolution to the City Council.

Sincerely,



PAUL J. SILVERN,
Partner

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

Land Cost Inflation

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

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

Construction Cost Inflation

Engineering News Record's Construction Cost Index

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

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

Derivation of Land Cost and Construction Cost Calculation Weights

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

Source: Housing Division, City of Santa Monica

Inflation Factor Derivation

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

Adjusted Fees

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

For Information Only:

Consumer Price Index Change, LA-Riv-Or Co.,

All Urban Consumers

Feb. 2005 Index Value 197.4

Feb. 2006 Index Value 207.5

Percentage Change 2005-2006 5.1%

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

Prepared by: Hamilton, Rabinovitz & Alschuler, Inc.