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The Economics of Land Use

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Draft Memorandum

To: Nell Selander, City of South San Francisco

From: Darin Smith and Andrei Dumitrescu

Subject: 7 South Linden Affordable Housing Agreement Amendment; EPS #251093

Date: December 1, 2025

EPS has reviewed the Affordable Housing Agreement (AHA) Amendment proposed by Essex ("the Developer") for the apartment complex currently under construction at 7 South Linden in South San Francisco. The Developer is requesting that the City allow the project to provide 10% of its units as "low income" priced at 80% of Area Median Income (AMI), rather than at the 60% AMI level required under the City's standard inclusionary housing ordinance. EPS understands that the Developer may have misunderstood the City's requirements during the entitlement period and created financing expectations based on the 80% AMI rents. The Developer asserts that applying the correct 60% AMI rent limits would result in a significant revenue loss of approximately 27% compared to their previous calculation of low-income unit rents. They further claim that every $100,000 in reduced annual revenue equates to a decrease of approximately $2 to $3 million in property value.

Using Year 2025 income limits and housing cost assumptions set by the California Department of Housing and Community Development (HCD) and utility allowances for the San Mateo County Housing Authority, EPS concludes that the Developer correctly represented the rents achievable at 60% AMI and 80% AMI. Taken alone, the 54 units to be rented at 60% AMI rather than 80% AMI would yield significantly less revenue, estimated by both the Developer and EPS at roughly $1.41 million versus $1.94 million per year, respectively. This is indeed a $527,000 or 27% reduction in achievable rent for those 54 units alone. However, the entire project is 543 units, including 462 units priced at market rates, and the $527,000 revenue reduction represents only 2.2% of the overall project's rental revenues.

The Developer has requested that they be allowed one of two different pricing arrangements for those 54 units: Concept 1) half of the 54 units priced at 70% AMI and half at 100% AMI, or Concept 2) half of the 54 units priced at 50% AMI and the other half priced at market rate. The Developer suggested that either of these alternatives would increase rent revenues relative to the City's standard inclusionary requirement. As shown on **Appendix A**, EPS confirms this general dynamic is true but has adjusted certain assumptions and calculations made.

EPS found that the Developer's achievable rent assumptions were incorrectly calculated for the Half 70% AMI/ Half 110% AMI scenario ("Concept 1"). According to their own data, current market rents are lower than the maximum rent allowed at 110% AMI, so they do not represent a discount from market-rate pricing or an enhancement of the City's affordable housing supply. EPS recalculated Concept 1's projected revenue to reflect market rents for the units nominally priced at 110% AMI. With this adjustment, Concept 1 actually results in a roughly $130,000 (0.6%) *increase* in total project revenue relative to the scenario in which they would offer 54 units at 80% AMI, and roughly $650,000 more than in the scenario in which they would be meeting the City's baseline inclusionary standards. Thus, this scenario would actually result in an improvement of the Developer's financial position relative to providing the 54 units at 80% AMI, and a meaningful reduction in the number of "Low Income" affordable units delivered by the project.

EPS has confirmed that the Developer correctly estimated that Concept 2 results in a roughly $158,000 (0.7%) decrease in total revenue relative to the scenario with 54 units at 80% AMI, and a $370,000 increase relative to meeting the City's inclusionary standards. In this scenario, the City would at least get an increase in the number of "Very Low Income" units relative to the inclusionary standards, though there would be no units offered at "Low Income."

EPS also evaluated the developer's assertion regarding the relationship between annual revenue loss and property value. It is true that reduced revenue will affect the valuation of a property, as most income-producing properties are valued based on a "capitalization rate" that represents the ratio of a given year's net operating income to the one-time amount a buyer will pay to receive that annual revenue. Current market data for multifamily properties in South San Francisco, as reported by CoStar and Integra IRR, indicate capitalization rates between 4.74% and 5%. Based on these contemporary figures, the actual loss in property value per $100,000 of annual income reduction is roughly $2 to $2.1 million, and the overall value impact of the $527,000 difference in "Low Income" unit rents to meet the City's inclusionary standards would affect the overall property valuation by roughly $10.5 to $11.1 million. While not insignificant, this again represents a roughly 2.2% difference in the overall project's valuation when accounting for all 543 units.

Overall, EPS finds that the financial impact of applying the correct affordable rent levels is modest in the context of the project's overall financing and revenue. While the reduction in property value is real, it is materially lower than represented by the Developer. Accurately incorporating affordable rent levels into financing is the responsibility of the developer and their lenders or equity partners, and the City may wish to consider the precedent-setting implications of granting concessions to correct errors in the developer's financial assumptions.

Appendix A

Income Level	Unit Type	With 54 Units at 80% AMI # of Units	Monthly Rent/Unit	Estimated Annual Revenue	With 54 Units at 60% AMI # of Units	Monthly Rent/Unit	Estimated Annual Revenue	With 54 Units Half 70% AMI/ Half 110% AMI # of Units	Monthly Rent/Unit	Estimated Annual Revenue	With 54 Units Half 50% AMI/ Half Market Rate # of Units	Monthly Rent/Unit	Estimated Annual Revenue
Market Rate													
	Studio	53	$2,992	$1,902,912	53	$2,992	$1,902,912	53	$2,992	$1,902,912	56	$2,992	$2,010,624
	1x1	214	$3,456	$8,875,008	214	$3,456	$8,875,008	214	$3,456	$8,875,008	227	$3,456	$9,414,144
	2x2	195	$4,380	$10,249,200	195	$4,380	$10,249,200	195	$4,380	$10,249,200	206	$4,380	$10,827,360
	Total	462		$21,027,120	462		$21,027,120	462		$21,027,120	489		$22,252,128
(50% AMI)													
	Studio	3	$1,501	$54,036	3	$1,501	$54,036	3	$1,501	$54,036	6	$1,501	$108,072
	1x1	13	$1,600	$249,600	13	$1,600	$249,600	13	$1,600	$249,600	25	$1,600	$480,000
	2x2	11	$1,902	$251,064	11	$1,902	$251,064	11	$1,902	$251,064	23	$1,902	$524,952
	Total	27		$554,700	27		$554,700	27		$554,700	54		$1,113,024
60% AMI													
	Studio				6	$1,844	$132,768						
	1x1				25	$2,115	$634,500						
	2x2				23	$2,343	$646,668						
	Total				54		$1,413,936						
(70% AMI)													
	Studio							3	$2,186	$78,705			
	1x1							13	$2,506	$390,975			
	2x2							11	$2,783	$367,389			
	Total							27		$837,069			
(80% AMI)													
	Studio	6	$2,530	$182,160									
	1x1	25	$2,898	$869,400									
	2x2	23	$3,223	$889,548									
	Total	54		$1,941,108									
(110% AMI) [1]													
	Studio							3	$2,992	$107,712			
	1x1							12	$3,456	$497,664			
	2x2							12	$4,380	$630,720			
	Total							27		$1,236,096			
Total Units		543			543			543			543		
Total Project Revenue				**$23,522,928**			**$22,995,756**			**$23,654,985**			**$23,365,152**
Net Change in Total Project Revenue relative to 54 Units at 80% AMI							**-$527,172**			**$132,057**			**-$157,776**
Net % Change in Total Project Revenue							**-2.2%**			**0.6%**			**-0.7%**

[1] Rent amount is the lesser of Market Rate and 110% AMI Rate.

Sources: Essex; California HCD; San Mateo County Housing Authority; EPS