
Inclusionary Housing (IH) Ordinance

Special Joint Study Session

July 26, 2023



May 16, 2023 Joint Study Session

- Keyser Marston Associates (KMA) presented a comprehensive overview of an inclusionary housing ordinance and its preliminary findings of the Financial Evaluation
- Public comments from Study Session included:
 - Ensure that the IH program helps address significant affordability issues within the City; target low and very-low income for rentals
 - Provide pathways to home ownership; allow in-lieu by right for ownership
 - Ensure that the IH program reflects market conditions

Financial Evaluation

- **May 16 Preliminary Findings:** prototypes analyzed in the preliminary findings were based on –
 - Vacant land scenario
 - Current densities allowed under the existing Zoning Code
 - IH requirement would apply to housing projects anywhere in the City
- **Updated FE:** includes additional analysis with prototypes based on –
 - City's rezoning areas identified in the Housing Element (HE)
 - Densities identified in the adopted HE
 - IH requirement would apply to housing projects in the specific rezoning areas

Prototypes in the Updated Financial Evaluation

- Prototypes developed based on the five existing urban plan areas and areas along the major corridors representative of the entire City.
- These are not actual projects but representative of recently developed or proposed housing projects in the City and representative of the properties identified in the adopted Housing Element's candidate housing opportunity sites.
- Prototypes assume a rezone scenario where a developed (or vacant) non-residential property would be rezoned to allow residential uses.

Prototypes – Ownership Housing

• Ownership Housing Prototypes:

- Densities analyzed range from 15 units/acre to 25 units/acre
- Site sizes range from 0.53 acres to 3.4 acres
- Parking standard assumed at 2 spaces/unit

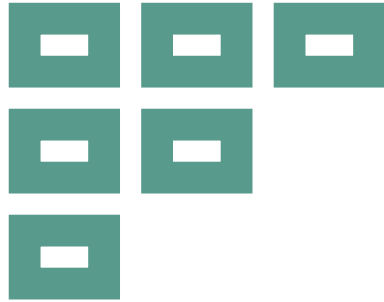


Prototypes – Rental Housing

• Rental Housing Prototypes:

- Densities analyzed range from 40 units/acre to 60 units/acre
- Site sizes range from 2 acres to 4 acres
- Parking standard assumed at 1.75 spaces/unit
- Density ranges analyzed consistent with adopted HE





Inclusionary Housing: Financial Evaluation City of Costa Mesa

PRESENTED BY KEYSER MARSTON ASSOCIATES, INC.

JULY 26, 2023

Financial Evaluation: Vacant Sites Analyses

MAY 16, 2023 STUDY SESSION

INCLUSIONARY HOUSING POLICY ISSUES

Fundamental Assumptions: Vacant Sites Analyses

The State Legislature and the courts have established parameters under which Inclusionary Housing programs must be structured.

There is a recognition that if incentives are not provided, the imposition of income and affordability restrictions impacts a project's economics.

The resulting legal limits on Inclusionary Housing Programs can be summarized as follows:

- The requirements cannot be confiscatory
- The requirements cannot deprive an owner of a fair and reasonable return on their investment.

Methodology: Vacant Sites Analyses

Financial Evaluation presented at the May 16th Study session was premised on the following assumptions:

- The Housing Element was reviewed to identify vacant potential residential development sites.
- Apartment and ownership housing development prototypes were created for testing purposes.
- The following pro forma analyses were performed:
 - A 100% market rate scenario was tested to identify the return that can be anticipated if no restrictions are applied.
 - Affordable housing units were incrementally added to measure the impacts created by an Inclusionary Housing requirement.
- The goal is to limit the Inclusionary Housing impacts to comport with the parameters applied by the State Legislature and the Courts.

Findings: Vacant Sites Analyses

Development Type	Supportable Inclusionary Housing Requirement
Apartments	
Low Income	10%
Very Low Income	7%
Section 65915 Density Bonus – Very Low Income	15%
Ownership Housing	
Moderate Income	8%
Low Income	5%

Financial Evaluation: Overlay Zones Analyses

Fundamental Assumptions: Overlay Zones Analyses

Primary goal is to create a program that provides sufficient incentives and benefits to offset the impacts created by the affordable housing requirements.

Overlay Zones deemed suitable for new residential development were identified in the Housing Element.

Zoning Code amendments are proposed to be enacted within the Overlay Zones.

- It is assumed that these amendments will enhance the value of properties located in the Overlay Zones.
- A fundamental premise is that a share of the enhanced value can be allocated to the impact created by the imposition of Inclusionary Housing requirements.

Site Selection Parameters: Overlay Zones Analyses

The following site selection parameters were applied in the Overlay Zone analyses:

- Sites that are currently developed with residential uses were excluded from the analyses.
- The following property types are included in the analyses:
 - Vacant residentially zoned properties that are appropriate for increased allowable density.
 - Vacant properties that are not currently zoned for residential development.
 - The following types of improved commercial properties:
 - Industrial
 - Industrial plus retail
 - Warehouse
 - Auto sales and service
 - Motel

Methodology Overlay Zones Analyses

Apartment and ownership housing development prototypes were created for testing purposes.

Market surveys were performed to identify:

- Land and improved property values
- Common apartment and ownership housing densities
- Apartment rents and ownership housing sales prices

The following analyses were performed to estimate:

- Property values as zoned and/or improved.
- Land values supported by market rate apartment or ownership housing development.
- Magnitude of the value enhancement created by the zoning modifications.
- Share of the value enhancement that can reasonably be committed to Inclusionary Units.
- Conversion to the supportable Inclusionary Housing requirements.

Apartment Development Analyses

Prototype Apartment Development Scenarios

Project Descriptions Apartment Development Prototypes			
Existing Use	Site Area (Acres)	Total Units	Density (Units/Acre)
Vacant Business Park Land	4.00	240	60
Improved Auto Property	2.40	96	40
Improved .39 FAR Industrial + Retail	4.30	172	40
Improved .39 FAR Industrial + Retail	2.00	80	40
Improved .49 FAR Industrial	2.40	120	50
Improved Auto Property	3.15	189	60

Common Assumptions

Prototype apartments include a mix of studios – three-bedroom units.

The rents range from \$2,410 - \$4,400 per month.

The affordable rents in 2023 are:

Number of Bedrooms	Low Income	Very Low Income
Studio	\$1,698	\$1,027
1	\$1,939	\$1,172
2	\$2,159	\$1,297
3	\$2,382	\$1,424

Pro Forma Results: Market Rate Scenarios

Estimated Residual Land Values 100% Market Rate Apartment Development Prototypes					
Existing Use	Construction Costs		Stabilized NOI	Residual Land Value	
	Total	Per Unit		Total	Per Square Foot
Vacant Business Park Land	\$96,481,000	\$402,000	\$6,512,000	\$29,646,000	\$170
Improved Auto Property	\$35,058,000	\$365,000	\$2,604,000	\$15,377,000	\$147
Improved .39 FAR Industrial + Retail	\$61,735,000	\$359,000	\$4,657,000	\$28,464,000	\$152
Improved .39 FAR Industrial + Retail	\$28,766,000	\$360,000	\$2,170,000	\$13,263,000	\$152
Improved .49 FAR Industrial	\$43,841,000	\$365,000	\$3,257,000	\$19,242,000	\$184
Improved Auto Property	\$75,975,000	\$402,000	\$5,128,000	\$23,346,000	\$170

Funds Available for Inclusionary Housing

The funds available for Inclusionary Housing are set at 50% of the value enhancement estimated to be achieved by the zoning modifications.

Existing Use	Estimated Land Value / Sq. Ft.			Contribution	
	Market Rate Apartments	- Existing Use	= Value Enhancement	Percentage Share	Total Contribution
Vacant Business Park Land	\$29,646,000	- \$11,326,000	= \$18,320,000	50%	\$9,160,000
Improved Auto Property	\$15,377,000	- \$11,182,000	= \$4,195,000	50%	\$2,098,000
Improved .39 FAR Industrial + Retail	\$28,464,000	- \$23,953,000	= \$4,511,000	50%	\$2,256,000
Improved .39 FAR Industrial + Retail	\$13,263,000	- \$11,141,000	= \$2,122,000	50%	\$1,061,000
Improved .49 FAR Industrial	\$19,242,000	- \$16,586,000	= \$2,656,000	50%	\$1,328,000
Improved Auto Property	\$23,346,000	- \$14,677,000	= \$8,669,000	50%	\$4,335,000

Supportable Inclusionary Housing Requirements

Supportable Inclusionary Housing Requirements Single Income Category Analyses Apartment Development Prototypes			
Area	Low Income Units	OR	Very Low Income Units
Vacant Business Park Land	19%		12%
Improved Auto Property	11%		7%
Improved .39 FAR Industrial + F	6%		4%
Improved .39 FAR Industrial + F	8%		4%
Improved .49 FAR Industrial	6%		3%
Improved Auto Property	12%		7%

Supportable Inclusionary Housing Requirements Mix of Income Categories Analyses Apartment Development Prototypes					
Existing Use	Low Income Units	+	Very Low Income Units	=	Total Obligation
Vacant Business Park Land	11%	+	5%	=	16%
Improved Auto Property	6%	+	3%	=	9%
Improved Auto Property	7%	+	3%	=	10%

Section 65915 Density Bonus: Impacts on Project Economics

An ancillary evaluation of Section 65915 density bonus projects was also prepared.

The key finding was that in general the additional density is not anticipated to enhance the project economics.

The primary reason is that the zoning modifications being considered by the City provide parking relief, which is a major reason developers opt to use the Section 65915 density bonus.

Recommended Inclusionary Housing Production Options

KMA recommends that the City provide the following menu of Inclusionary Housing production options:

Density Range	Low Income Units	+	Very Low Income Units	=	Total Obligation
0 to 39 Units Per Acre	6%	+	0%	=	6%
<u>40 to 59 Units Per Acre</u>					
Low Income Only	11%	+	0%	=	11%
Very Low Income Only	0%	+	7%	=	7%
Low & Very Low Income	6%	+	3%	=	9%
<u>60+ Units Per Acre</u>					
Low Income Only	19%	+	0%	=	19%
Very Low Income Only	0%	+	12%	=	12%
Low & Very Low Income	11%	+	5%	=	16%

Ownership Housing Development Analyses

Prototype Ownership Housing Development Scenarios

Project Descriptions Ownership Housing Development Prototypes				
Existing Use	Site Area (Acres)	Total Units	Density (Units/Acre)	Bedroom Mix
Vacant Residential Land @ 20 Units/Acre	3.40	85	25	2 - 4
Improved .39 FAR Industrial + Retail	0.53	8	15	3 & 4
Improved Auto Property	1.18	20	17	3 & 4
Improved .39 FAR Industrial + Retail	2.00	40	20	2 - 4
Improved .42 FAR Industrial + Retail	0.67	11	16	3 & 4
31 Room Motel	0.63	10	16	3 & 4

Pro Forma Results: Market Rate Scenario

Estimated Residual Land Values 100% Market Rate Ownership Housing Development Prototypes					
Existing Use	Construction Costs		Average Sales Price Per Unit	Residual Land Value	
	Total	Per Unit		Total	Per Square Foot
Vacant Residential Land @ 20 Units/Acre	\$55,435,000	\$652,000	\$1,055,000	\$20,826,000	\$141
Improved .39 FAR Industrial + Retail	\$5,448,000	\$681,000	\$1,252,000	\$3,262,000	\$141
Improved Auto Property	\$13,348,000	\$667,000	\$1,193,000	\$7,174,000	\$140
Improved .39 FAR Industrial + Retail	\$25,986,000	\$650,000	\$1,103,000	\$11,961,000	\$137
Improved .42 FAR Industrial + Retail	\$7,389,000	\$672,000	\$1,222,000	\$4,298,000	\$147
31 Room Motel	\$6,701,000	\$670,000	\$1,210,000	\$3,818,000	\$139

Funds Available for Inclusionary Housing

The funds available for Inclusionary Housing are set at 50% of the value enhancement estimated to be achieved by the zoning modifications.

Existing Use	Estimated Land Value / Sq. Ft.			Contribution	
	Market Rate Units	- Existing Use	= Value Enhancement	Percentage Share	Total Contribution
Vacant Residential Land @ 20 Units/Acre	\$20,826,000	- \$11,552,000	= \$9,274,000	50%	\$4,637,000
Improved .39 FAR Industrial + Retail	\$3,262,000	- \$2,955,000	= \$307,000	50%	\$154,000
Improved Auto Property	\$7,174,000	- \$5,500,000	= \$1,674,000	50%	\$837,000
Improved .39 FAR Industrial + Retail	\$11,961,000	- \$11,151,000	= \$810,000	50%	\$405,000
Improved .42 FAR Industrial + Retail	\$4,298,000	- \$3,736,000	= \$562,000	50%	\$281,000
31 Room Motel	\$3,818,000	- \$6,504,000	= (\$2,686,000)	No Contribution is Supported	

Affordability Gap Analyses

As shown in the table below, there are large gaps between the achievable market rate sales prices and the defined moderate income prices:

Existing Use	Average Sales Price Per Unit	-	Average Moderate Income Price	=	Affordability Gap
Vacant Residential Land @ 20 Units/Acre	\$1,055,000	-	\$498,000	=	\$557,000
Improved .39 FAR Industrial + Retail	\$1,252,000	-	\$507,000	=	\$745,000
Improved Auto Property	\$1,193,000	-	\$509,000	=	\$684,000
Improved .39 FAR Industrial + Retail	\$1,103,000	-	\$500,000	=	\$603,000
Improved .42 FAR Industrial + Retail	\$1,222,000	-	\$508,000	=	\$714,000
31 Room Motel					Not Applicable

Supportable Inclusionary Housing Requirements

Existing Use	Moderate Income Units
Vacant Residential Land @ 20 Units/Acre	9.8%
Improved .39 FAR Industrial + Retail	2.5%
Improved Auto Property	6.1%
Improved .39 FAR Industrial + Retail	1.7%
Improved .42 FAR Industrial + Retail	3.5%
31 Room Motel	N/A

Recommended Inclusionary Housing Production Requirements

Given the magnitude of the Affordability Gaps associated with new ownership housing units KMA recommends that developers be permitted to pay a fee in lieu of producing affordable housing units.

KMA further recommends that the in-lieu revenue be used to create a first time homebuyer program that provides assistance to households who wish to purchase an existing home in Costa Mesa.

Recommendations

Income and Affordability Requirements

Apartment Development

<u>Density Range</u>	<u>Low Income Units</u>	+	<u>Very Low Income Units</u>	=	<u>Total Obligation</u>
0 to 39 Units Per Acre	6%	+	0%	=	6%
<u>40 to 59 Units Per Acre</u>					
Low Income Only	11%	+	0%	=	11%
Very Low Income Only	0%	+	7%	=	7%
Low & Very Low Income	6%	+	3%	=	9%
<u>60+ Units Per Acre</u>					
Low Income Only	19%	+	0%	=	19%
Very Low Income Only	0%	+	12%	=	12%
Low & Very Low Income	11%	+	5%	=	16%

Ownership Housing Development

On-site production of Inclusionary Units should not be required

Other Fulfillment Recommendations

	Apartment Development	Ownership Housing Development
Threshold Project Size	5 units	5 units
Covenant Period	Not less than 55 years. After 55 years, the covenant should only be removed if the property is put to a non-residential use.	Over one cumulative 45-year period the home must be sold and resold to a moderate income household at the affordable price.
In-Lieu Fee Payment	Fractional Inclusionary Unit Obligations	
	Projects with 100 or fewer units	Projects of any size
Alternative Production Options	Not Recommended	Affordable apartment units mixed with the ownership housing units, or on a separate parcel within the ownership housing site.

Implementation Recommendations

Marketing Requirements

Require developers to prominently advertise the affordable units locally. Provide the marketing information on the City's website.

§65915 Density Bonus

City is currently amending the density bonus ordinance to reflect changes made by the State. Until the update is codified, State Law will prevail.

Affordable Housing Regulations

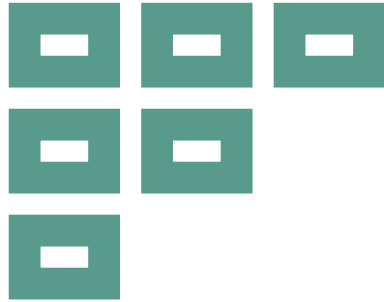
Separate Affordable Housing Regulations should be prepared for Apartment and Ownership Housing development.

Program Updates

Re-evaluate the program at least every five years. Adjust the in-lieu fee annually based on a defined index.

Staffing Plan

Create a staffing plan for managing the development process and ongoing monitoring.



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