



Agenda Report

Item #: 24-066

Meeting Date: 2/27/2024

TITLE: STUDY SESSION REGARDING THE PROPOSED IN-LIEU HOUSING FEE, STATE DENSITY BONUS AND AFFORDABLE HOUSING STRATEGIES AND OPTIONS

DEPARTMENT: ECONOMIC AND DEVELOPMENT SERVICES DEPARTMENT/PLANNING DIVISION

PRESENTED BY: SCOTT DRAPKIN, ASSISTANT DEVELOPMENT SERVICES DIRECTOR AND NANCY HUYNH, PRINCIPAL PLANNER

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RECOMMENDATION:

Staff recommends the City Council receive the staff presentation and provide direction on proposed in-lieu housing fee amounts and subsequent fee resolution for potential future City Council adoption.

BACKGROUND:

In recent decades there has been an under-building of housing for lower- and middle-income households. The goal of an affordable housing ordinance is to ensure housing is built to serve households at all income levels and that much needed affordable housing is produced along with market-rate units. The proposed affordable housing program is intended to promote the development of affordable housing without unduly constraining the creation of market rate housing. The ordinance proposed carefully balances the City's housing needs with the needs of property owners and developers, while also considering the added value from future rezoning to allow more or new density.

The proposed ordinance assists in two distinct ways to provide affordable housing opportunities in the City. First, it leverages the private sector's capacity to get homes built, where other affordable housing strategies rely on government or non-profit agencies to build new homes. Requiring affordable units as part of new residential development ensures units are built onsite and integrated into a housing project to the greatest extent possible. Further, it creates a new source of financing for affordable housing with the payment of funds in-lieu of the project proponent providing the specified affordable units onsite, providing developers with more flexibility.

Planning Commission Recommendation

On November 13, 2023, the Planning Commission reviewed Ordinance No. 2024-XX to amend Title 13 (Planning, Zoning and Development) of the Costa Mesa Municipal Code (CMMC) to establish affordable housing requirements for new residential development projects. The Planning Commission recommended changes to the draft ordinance and voted 5-2 (Commissioner Zich and Commissioner Andrade voting no) to recommend the City Council give first reading of Ordinance No. 2024-XX with their proposed changes.

The November 13, 2023, Planning Commission agenda report is attached to this report, and the meeting video, and public comments are included in the links below:

- November 13, 2023 Planning Commission Meeting Video:
https://costamesa.granicus.com/player/clip/4063?view_id=14&redirect=true&h=f22a251337c41bee55301395ff67cc2
- November 13, 2023 Planning Commission Public Comments:
<https://costamesa.legistar.com/View.ashx?M=E3&ID=1135455&GUID=7ECD4C06-87E5-4283-8149-4BFF97215AA2>

City Council First Reading

On January 16, 2024, the City Council considered the Planning Commission's recommendations, discussed the draft ordinance and made further changes to the draft including:

- Establishing a minimum threshold project size for application of the affordability requirements
- Requiring the onsite production of affordable units for rental projects with over 50 units
- Allowing payment of in-lieu housing fees for rental projects with fewer than 50 units
- Allowing a residential project for which the City enters into a development agreement to provide an affordable housing equivalent to the AHO or equivalent community benefit

The City Council voted 4-2 (Councilmember Chavez and Mayor Pro Tem Harlan voting no; Councilmember Harper absent) to give first reading of Ordinance No. 2024-XX. The January 16, 2024 City Council agenda report is attached to this report, and the meeting video, and public comments are included in the links below:

- January 16, 2024 City Council Meeting Video:
https://costamesa.granicus.com/player/clip/4078?view_id=14&redirect=true
- January 16, 2024 City Council Public Comments:
<https://costamesa.legistar.com/View.ashx?M=E3&ID=1144863&GUID=584645D0-2AD4-4EB6-9E72-78009403D0D6>

As part of the discussion regarding an inclusionary housing ordinance, the City Council directed staff to provide an in-lieu housing fee analysis for their review and consideration at the second reading of the ordinance. The second reading of the ordinance and proposed resolution to adopt an in-lieu housing fee schedule is tentatively planned for the March 19, 2024, City Council meeting date. This Study Session is intended to provide the City Council with a focused review of the proposed in-lieu housing fee calculations and applicable affordable local and State housing provisions, and provide the City Council with an opportunity to review and analyze the fees and their future potential application.

Proposed Affordable Housing Requirements

The table below provides a summary of the proposed affordable housing ordinance which reflects the City Council's revisions during the first reading.

Table 1 – Summary of Affordable Housing Program Proposed Requirements

PROGRAM COMPONENT	CITY COUNCIL'S PROPOSED REQUIREMENTS
Project Threshold	15 units
Number of Affordable Units/Required Income – Rental Project	• 60+ dwelling unit (du)/acre: 11% at low-income or 7% at very-low income • Under 60 du/acre: 6% at low-income or 4% at very-low income
Number of Affordable Units/Required Income – Ownership Project	Payment of in-lieu fee
Covenant Period – Rental	At least 55 years
Covenant Period – Ownership	45 years (if producing affordable units onsite)
Affordable Unit Minimum Size	No more than 15% smaller than average market rate unit
Affordable Unit Bedroom Mix	Proportional to market rate units
Affordable Unit Location	Evenly distributed/dispersed throughout residential project
Alternatives for Compliance	• Land dedication • Offsite construction of affordable units • Payment of in-lieu fees: ○ <i>Ownership</i>: All ownership projects can pay in-lieu fee ○ <i>Rental</i>: Rental projects fewer than 50 units can pay in-lieu fee • Onsite construction of rental units (ownership only)
Incentives	• Allow residential uses in commercial/industrial corridors • Increased densities • Allow low-income rents to be charged based on 80% AMI vs. 60% AMI (required by State density bonus) • Reduced parking requirements • Concurrent processing

ANALYSIS:

As summarized in Table 1, the proposed affordable housing ordinance (AHO) imposes affordable housing requirements on housing projects with more than 15 units. The AHO is based on an on-site production requirement, but it also provides for multiple compliance options, including payment of a fee in lieu of producing affordable housing units.

The AHO is intended to be coupled with zoning code amendments in defined overlay areas in Costa Mesa. As indicated in Table 1 above, the proposed AHO provisions allow residential uses in commercial and industrial corridors, and at higher densities and at lower required parking ratios than are currently allowed for residential development. These benefits are meant to assist in mitigating the impacts created by the imposition of affordable housing requirements.

State Density Bonus and Local Affordable Housing Program Strategies

It is important to note that residential developers can choose by right to use California's Density Bonus Law, which is codified in Government Code §65915 et seq. (State Density Bonus) for projects that adhere to the minimum criteria defined below:

- 5% units restricted to "Very Low Income"
- 10% units restricted to "Low Income" rental units or 10% "Moderate Income" for sale units
- 100% affordable units (excluding manager's units) with a maximum of 20% moderate units
- 10% "Very Low Income" units restricted for transitional foster youth, disabled veterans, or homeless
- 20% "Low Income" units for student housing at accredited colleges.
- A senior housing development.
- An age-restricted mobile home park
- The project donates at least one acre of land to the jurisdiction for very low-income units, the land has the appropriate permits and approvals, and has access to needed public facilities
- Projects which include a child care facility

State Density Bonus allows for increased housing density on a property above the maximum allowed under the City's General Plan Land Use Element, a statutorily defined number of concessions/incentives, and potentially reductions and/or waivers to the City's development standards. The draft affordable housing ordinance is proposed to be designed to specifically include similar and in certain situations potentially greater housing development incentives than allowed by State Density Bonus Law. For example, the proposed AHO allows the affordable rents for low income units to be calculated based on 80% of the area median income (AMI), while State Density Bonus requires the rents to be calculated based on 60% of AMI. In addition, the City's amended parking standards are proposed to be based on demonstrated market demand. The intention of the AHO is to create sufficient incentives through the proposed zoning code amendments to incentivize affordable housing construction that serves the local households at all income levels, and is also consistent with the communities housing values.

The proposed AHO includes Section 13-334 - Density Bonus. This section stipulates that if an applicant proposes to use the State Density Bonus, the affordable units used to fulfill the density bonus requirements may also count as affordable units required by the City's' proposed AHO only if the more stringent requirements of the two programs are applied.

As discussed previously, the proposed AHO provides for multiple options for fulfilling the identified affordable housing obligations. However, it is important to note that if the in-lieu fee option is selected, the proposed market rate residential development will not meet the State Density Bonus eligibility requirements.

As drafted in the AHO, the option to pay the in-lieu housing fees would be specifically allowed with ownership housing projects with 15 or more units, and rental housing projects with 15 to 50 units. Unless approved otherwise by the City, a rental housing project proposed with over 50 units would be required to produce the affordable units onsite within their market rate project. However, should it be determined that onsite affordable housing production is not feasible in housing developments over 50

units, the proposed ordinance allows (with City approval) an in-lieu housing fee to be paid when it can be demonstrated that new construction of the required affordable units would create an unreasonable hardship due to such factors as project size, site constraints, and/or excessively large affordability gaps. The ultimate burden is on the developer to prove that none of the affordable housing production alternatives provided for in the Inclusionary Housing Ordinance can be used without creating an economic hardship on the project.

In-Lieu Fee Analysis

The City's consultant, Keyser Marston Associates (KMA), prepared the in-lieu housing fee analysis based on the percentages provided in Table 1 above and the "affordability gap." The affordability gap is the total sales or net rent cost difference between a market rate unit and affordable unit. KMA estimates the affordability gap using 2024 average rent/sales price data and unit sizes from rental and ownership housing projects in Costa Mesa. The affordability gap is then multiplied by each of the City's affordable housing requirement percentages.

For rental projects, the in-lieu housing fee payment is dependent on the project density (60+ dwelling unit per acre or less than a 60 dwelling unit per acre project). The recommended base in-lieu fees for proposed rental projects are set at \$26.10 or \$13.80 per square foot of leasable area, respectively. The in-lieu fee payment for ownership housing developments does not vary by project density. The recommended base in-lieu fee for ownership housing projects is set at \$17.70 per square foot of saleable area. KMA's in-lieu housing fee analysis study is included as Attachment 1 to this Agenda Report.

For discussion purposes and as recommended by the Planning Commission, KMA also prepared a supplemental in-lieu housing fee analysis for certain rental projects using a 10% low-income and 5% very-low income requirement. The City Council at their first reading considered these percentages; however, ultimately voted to establish the requirements based on staff and KMA's affordable housing set-aside recommendations. KMA's supplemental in-lieu housing fee analysis is also included with Attachment 1.

Proposed In-Lieu Housing Fee Schedule

Although the in-lieu housing fee payment option is allowed for rental projects at 15 units, the proposed in-lieu housing fee schedule also includes a "sliding scale" to account for the disproportionate impact that the fee may have on smaller projects. As such, the proposed fee for smaller projects designed with 15 to 20 units would be discounted. Projects over 20 units would be required to pay the full fee amount. A project's total required in-lieu housing fee amount is calculated based on the project's total leasable area (for rentals) or saleable area (for ownership). Table 2 below shows the proposed discounted rate for smaller rental projects and Table 4 below shows the proposed discounted rate for smaller ownership housing projects.

Rental Housing Projects

The proposed fee schedule for rental housing projects is shown in Table 2 below. Since there are two different requirement "tiers" for rental housing projects (60 du+/acre and under 60 du/acre), Table 2 shows the fees for each type of rental project. The maximum fee amount for the higher density rental

projects would be \$26.10 per a project's leasable area (per square foot). For the lower density rental projects, the maximum fee amount would be \$13.80 per a project's leasable area (per square foot).

**Table 2 – Rental Housing Projects In-Lieu Fee Schedule
(Pursuant to Draft Ordinance No. 2024-XX)**

Recommended In-Lieu Fee Payment Schedule Per Square Foot of Total Leasable Area in an Apartment Development		
Total Units	Density: 60+ Units Per Acre	Density: <60 Units Per Acre
15	\$3.73	\$1.97
16	\$7.46	\$3.94
17	\$11.19	\$5.91
18	\$14.91	\$7.89
19	\$18.64	\$9.86
20	\$22.37	\$11.83
21+	\$26.10	\$13.80

For discussion purposes, Table 3 below shows the proposed in-lieu housing fee schedule based on the affordable percentages as recommended by the Planning Commission (60+ du/acre rental projects at 10% low-income or 5% very-low income), and also includes a discounted rate for smaller rental projects between 15 and 20 units.

Table 3 – 60+ du/acre In-Lieu Fee Schedule at 10% Low and 5% Very-Low Incomes

In-Lieu Fee Payment Schedule Per Square Foot of Total Leasable Area in an Apartment Development	
Units	In-Lieu Fee
15	\$2.79
16	\$5.57
17	\$8.36
18	\$11.14
19	\$13.93
20	\$16.71
21+	\$19.50

Ownership Housing Projects

The proposed fee schedule for ownership housing projects is shown in Table 4 below. The maximum fee amount would be \$17.70 per a project's saleable area (per square foot) and includes a discounted rate for smaller ownership projects between 15 and 20 units.

Table 4 – Ownership Housing Projects In-Lieu Fee Schedule

Recommended In-Lieu Fee Payment Schedule Ownership Housing Development Prototype	
Total Units	In-Lieu Fee Per Square Foot of Saleable Area
15	\$2.53
16	\$5.06
17	\$7.59
18	\$10.11
19	\$12.64
20	\$15.17
21+	\$17.70

Comparison of Surrounding Cities In-Lieu Fees

Each local jurisdiction's affordable housing in-lieu fees are specific to that jurisdiction's affordable housing requirements as well as the current real estate local market conditions (e.g., average rent and sales price and land values). As such, the fees and fee calculation vary from each jurisdiction. Nevertheless, a comparison between the City's proposed fee schedules and Huntington Beach and Santa Ana's in-lieu housing fees are provided in Table 5 below. The City's proposed fees are generally consistent with both cities and in some cases lower.

Table 5 – In-Lieu Fees Comparison

Santa Ana¹	<u>Flat fee for rental and ownership:</u> • 5 to 9 units: \$6 • 10 to 14 units: \$9 • 15 to 19 units: \$12 • 20+ units: \$20
Huntington Beach^{2,3}	<u>Sliding scale between 3 and 30+ units:</u> • Rental: \$3.58 to \$35.80 • Ownership: \$2.54 to \$25.36
Costa Mesa^{2,4}	<u>Sliding scale between 15 and 20+ units:</u> • Rental – 60+ du/acre: \$3.73 to \$26.10 • Rental – under 60 du/acre: \$1.97 to \$13.80 • Ownership: \$2.53 to \$17.70
¹ Fees calculated based on square feet of habitable area. ² Fees calculated based on leaseable/saleable area. ³ Payment of in-lieu fees allowed for projects up to 100 units ⁴ Payment of in-lieu fees allowed for projects between 15 and 50 units	

Project Examples

To demonstrate how the proposed in-lieu housing fees would apply to a housing project subject to the AHO requirements, both a rental and ownership project example is provided below. The project examples used are from existing housing developments located within the City. The estimated in-lieu housing fee calculation is based on the proposed AHO set-aside percentages.

Rental Housing Project: 60+ du/acre Example

Illustratively, a rental housing project constructed on an approximate half-acre parcel in Costa Mesa with a total of 23 units (60 du/acre). The project includes 23 units in 17,000 square feet of leasable area. Since the project is less than 50 units, under the proposed AHO, the developer could request to fulfill their housing obligation with payment of in-lieu housing fees. The in-lieu fee payment amounts are based on the schedule presented in Table 2, and the calculations are presented in the following table.

Table 6 – Rental Housing Project 60+ du/acre In-Lieu Fee Example and Comparison

Affordable Housing Alternative	11% Low or 7% Very Low Income	10% Low or 5% Very Low Income
Affordable Units	3 Low or 2 Very Low	2 Low or 1 Very Low
Basis for the In-Lieu Fee ¹	Low Income Std.	Very Low Income Std.
In-Lieu Fee Per SF	\$26.10	\$19.50
Leasable Area (SF)	17,000	17,000
Total In-Lieu Fee	\$443,700	\$331,500

Rental Housing Project: Less than 60 du/acre Example

Baker Block was developed in 2014 on a 4.2-acre property that was rezoned from an industrial zone to a high-density residential zone and includes a total of 240 apartment units (57.7 du/acre) which meets the project threshold size subject to the AHO requirements. Since the project proposes over 50 rental units, it must produce required affordable units on site within the market project. If the developer has demonstrated that onsite production would not be feasible, they could request to fulfill their obligation with payment of in-lieu fees. Using the fee schedule in Table 2 above, the project's required in-lieu fee is calculated in the table below.

Table 7 – Rental Housing Project Under 60 du/acre In-Lieu Fee Example

Total Units	240
6% Low or 4% Very Low Income	14 Low or 10 Very Low
Basis for In-Lieu Fee	Low Income Std.
Required In-Lieu Fee	\$13.80
Leasable Area	220,000 SF
Total In-Lieu Fee Payment	\$3,036,000

¹ The In-Lieu Fee is based on the income standard that generated the lower payment amount of the two income levels.

Ownership Housing Project Example

Aura was developed in 2018 on a 3.7-acre property that was rezoned from commercial to medium-density residential and includes a total of 33 single-family detached condominiums (8.9 du/acre). Since the project proposes all ownership housing units, under the proposed ordinance, the developer may pay the in-lieu housing fee to fulfill their AHO obligation. Using the fee schedule in Table 4 above, the project's required in-lieu housing fee is calculated in the table below.

Table 8 – Ownership Housing Project In-Lieu Fee Example

Total Units	33
Required In-Lieu Fee	\$17.70
Saleable Area	73,000 SF
Total In-Lieu Fee Payment	\$1,292,100

Next Steps

Following this study session, staff would prepare the updated AHO with the City Council's modifications from the first reading, if any. The second reading of the ordinance, as well as a separate resolution and revised Master Fee and Charges Schedule reflecting the proposed in-lieu fees would be prepared for City Council's review and potential adoption at their regular meeting on March 19, 2024. Should the City Council give second reading of Ordinance No. 2024-XX and adopt the fee resolution, the ordinance would become effective 30 days after adoption. As recommended by KMA, the AHO including the in-lieu housing fee schedule would be re-evaluated regularly.

ALTERNATIVES:

The City Council could provide staff with alternative feedback and direction prior to the second reading of the Ordinance and in-lieu housing fee resolution.

FISCAL REVIEW:

Should the City Council adopt the Affordable Housing Ordinance and in-lieu housing fee resolution, the City could potentially receive funding from payment of fees that would be deposited into a Housing Trust Fund to support and promote affordable housing programs in the City, including the administration of the City's affordable housing program.

LEGAL REVIEW:

The City Attorney's Office has reviewed and approved this report as to form.

CITY COUNCIL GOALS AND PRIORITIES:

This item supports the following City Council Goal:

- Diversify, Stabilize and Increase Housing to Reflect Community Needs

CONCLUSION:

Consideration of an affordable housing ordinance has been included in the City's Housing Element as part of an overall strategy to promote the creation of additional housing supply that is affordable to all segments of the Costa Mesa community. In addition, the affordable housing ordinance is included as a strategic plan objective and priority to accomplish the City Council's goal to "*diversify, stabilize and increase housing to reflect the community needs*".

Staff is seeking feedback from the City Council regarding the proposed in-lieu housing fee schedules to accompany the second reading of draft Ordinance No. 2024-XX (Affordable Housing Ordinance) for potential adoption.