



Inclusionary Housing Policy Issues City of Costa Mesa

PRESENTED BY KEYSER MARSTON ASSOCIATES, INC.

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Inclusionary Housing Program Context

Foundational Concepts

Over 170 jurisdictions in California include an Inclusionary Housing program as one component of their affordable housing strategy.

It is important to understand that an Inclusionary Housing Program can only be expected to fulfill a small part of the unmet need for affordable housing in the community.

Inclusionary Housing Survey: 98 California Jurisdictions

Most Inclusionary Housing programs include a threshold project size:

- Common thresholds range from 3 to 10 units.
- The average and median threshold project sizes are 7 and 5 units, respectively.

Income and affordability requirements vary widely. Majority of the surveyed programs impose a 10% to 20% requirement:

- The thresholds tend to reflect the depth of the affordability standards being required.
- The requirements have a disproportionate impact on smaller projects, due to fewer market rate units available to spread the financial impacts. Sliding scale requirements are sometime used.

The covenant periods are often set at 45 years for ownership projects and 55 years for apartment projects. Shorter and longer periods are applied in some jurisdictions.

INCLUSIONARY HOUSING PROGRAM SURVEYS - ORANGE COUNTY

Jurisdiction	Compliance Options	Set Aside %	Rental Development			Ownership Development			In-Lieu Fee
			Threshold Project Size	% of AMI	Covenant Period	Threshold Project Size	% of AMI	Covenant Period	
Brea	Create on-site units; pay in-lieu fee. City provides incentives to mitigate the impact of the requirement	10%	20	Undefined Percentages of Very Low & Low	55	20	120%	10	Calculated per project. Based on the Affordability Gap
Huntington Beach	Create on-site units; create off-site units; preserve or rehab existing housing; pay in-lieu fee	10%	3	80%	55	3	120%	45	Sliding Scale: 3 to 30 units. In-Lieu Fee allowed for projects up to 100 units. Rental: \$3.58 to \$35.80/SF Ownership: \$2.54 to \$25.36/SF. The per SF measurement caps at 2,000 SF.
Irvine	Projects with fewer than 50 units can create on-site units; convert market rate housing to affordable housing; extend the term of an existing affordable project; pay in-lieu fee; transfer units to a nonpot housing agency; create off-site units; donate land. Projects with 50+ units must produce the affordable units on site.	15%	Ordinance applies to all housing projects. 50 unit threshold for the production	5% @ 50% + 5% @ 80% + 5% @ 120%. Defined credits for deeper affordability & # of bedrooms.	30	Ordinance applies to all housing projects. 50 unit threshold for the production	5% @ 50% + 5% @ 80% + 5% @ 120%. Defined credits for deeper affordability & # of bedrooms.	30	Calculated per project. The calculation methodology is based on the average land value in Irvine, the average density of housing in Irvine, and a defined predevelopment cost allowance. Formula: [(Land Value ÷ Density) + Predevelopment Allowance] x Percentage Share of Cost related to affordable units not being produced
Laguna Woods	Create on-site units; create off-site units; pay in-lieu fee; donate land	15%	5	7.5% @ VL + 7.5% @ Low	45	5	10% @ Low + 5% @ Mod	45	Allowed for ownership housing projects that can prove that including affordable units is financially infeasible. The fee is calculated based on an affordability gap approach.
San Clemente	Create on-site units; create off-site units, pay in-lieu fee; donate land.	4%	6	Very Low	30	6	Very Low	30	Greater of 1% of construction costs as determined by the Building Division or 2% of the affordability gap determined by the formula in the Housing Element.
San Juan Capistrano	Create on-site units; create off-site units; preserve or rehab existing housing; pay in-lieu fee; donate land	10%	2		55	2		55	Based on 90% of the Affordability Gap, which is updated monthly based on benchmark market prices
Santa Ana	Only applies to changes in land use and zoning designations. Create on-site units; off-site units; pay in-lieu fee	Rental: 5% / 15% & Own: 5%	5	15% @ Low or 10% @ VL or 5% @ ELI or 5% Low	55	5	120%	55	Fee charged per sf of habitable area: 5-9: \$6.00; 10-14: \$9.00; 15-19: \$12; 20+: \$15. Discounts for use of skilled and trained labor force

Income and Affordability Considerations

Inclusionary Housing programs tend to set the affordability level for ownership units at the moderate income level. This reflects the need for significant disposal income to support the high cost of home ownership.

AB 1505, and subsequent HCD guidance, strongly recommend limiting the affordability level on apartment units to 80% of AMI:

- Deeper affordability requirements should not be applied to projects that fulfill the Inclusionary Housing requirements on site within the market rate project.
- Stricter standards can be applied to an off-site production option.
- Developers who use the State density will likely propose to fulfill the affordability requirements with very low income units.

Program Standards for the City Council to Establish

The minimum project size that will trigger the requirement.

Target income and affordability standards.

Covenant periods.

Alternative options to the requirement to fulfill the affordable housing requirement on-site within the market rate project:

- In-lieu fee payment
- Off-site production option
- Land dedication
- Acquisition and substantial rehabilitation of existing apartment units.

Financial Evaluation

Financial Evaluation Organization

- Step 1: Identified the “Residential Prototypes” using the March 1, 2023 draft Housing Element and the results of KMA’s market surveys. The prototypes do not represent actual projects. They are a composite of many factors.
- Step 2: Conducted a pro forma analysis for each Residential Prototype – first assuming a 100% market rate project.
- Step 3: Based on the results of Step 2, affordable housing units were incrementally added into the pro forma to measure the impacts of an Inclusionary Housing requirement.
- Step 4: The goal is to limit the Inclusionary Housing standards to avoid requirements that are confiscatory or that deprive an owner of a fair and reasonable return on investment.

Apartment Development Analyses

Base Zoning Prototype

Density – Units Per Acre	20		
Average Unit Size – Square Feet	990		
Total Development Costs Per Unit	\$570,000		
Rent Estimates	Market Rate	Low Income	Very Low Income
Studio Units	\$2,410	\$1,576	\$951
One-Bedroom Units	\$2,970	\$1,800	\$1,085
Two-Bedroom Units	\$3,660	\$2,003	\$1,199
Three-Bedroom Units	\$4,400	\$2,208	\$1,315
Supportable Inclusionary Requirement	10%		7%

Section 65915 Density Bonus



State density bonus can potentially mitigate the impacts of affordable housing requirements by allowing an increased number of units plus one to three incentives or concessions such as height and floor area ratio increases.



Projects that use the State density bonus cannot pay a fee in lieu of producing affordable housing units.



KMA analyzed a prototype density bonus apartment project at the maximum bonus provided by §65915.

Section 65915 Density Bonus Prototype

Density – Units Per Acre	30	
Average Unit Size – Square Feet	990	
Total Development Costs Per Unit	\$457,000	
Rent Estimates	Market Rate	Very Low Income
Studio Units	\$2,410	\$952
One-Bedroom Units	\$2,970	\$1,085
Two-Bedroom Units	\$3,660	\$1,199
Three-Bedroom Units	\$4,400	\$1,315
Supportable Inclusionary Requirement	15%	

Next Steps – Apartment Development Projects

The analysis indicates that the \$65915 density bonus can potentially offset the financial impact created by the imposition of Inclusionary requirements.

The draft Housing Element identifies multiple areas in which rezoning is being contemplated that will allow for increased densities.

It is KMA's recommendation that the rezoning be coupled with the imposition of affordable housing requirements.

With City Council policy direction, KMA will work with City staff to identify supportable affordable housing requirements at varying densities.

Ownership Housing Development Analyses

Development Characteristics

	Townhomes	Live/Work	Condominiums
Density – Units Per Acre	20	16	25
Average Unit Size – Square Feet	1,740	1,850	1,540
Total Development Costs Per Unit	\$869,000	\$922,000	\$841,000
Market Rate Sales Prices			
Two-Bedroom Units	\$846,000	\$959,000	\$806,000
Three-Bedroom Units	\$1,148,000	\$1,208,000	\$1,027,000

Sales Price Comparisons

	Two-Bedroom Units	Three-Bedroom Units
Market Rate Price	\$806,000 - \$959,000	\$1,027,000 - \$1,208,000
Moderate Income Price	\$439,900	\$465,800
Low Income Price	\$203,300	\$210,300

Supportable Inclusionary Housing Requirement

	Moderate Income	Low Income
Townhomes	8%	5%
Live/Work	7%	5%
Condominiums	8%	6%

Fulfillment Alternatives

In-Lieu Fee Payment Considerations

Will in-lieu fee payments be allowed by right, or only under defined circumstances? Considerations are:

- Program goals
- Ownership housing versus apartment projects
- Project size thresholds
- Community's views on density
- City responsibility to implement the affordable housing development

Establishing the in-lieu fee payment amounts:

- Affordability gap methodology
- An in-lieu fee calculated on a project-by-project basis based on a defined formula
- A discounted amount to encourage payment of the in-lieu fee
- A schedule that provides reduced in-lieu fees for small projects

Other Fulfillment Options for Consideration

Parcelization to create an affordable housing site:

- Opportunity to develop an apartment project at deeper affordability.
- Provides the affordable units in the same location as the market rate project.

Off-site production of affordable units:

- Tenure decision – apartment units as a requirement?
- Unit comparability
- Proximity to the market rate project?

Land dedication:

- Appropriate site for fulfilling the affordable housing obligations.
- City responsibility for developer selection.
- Proximity to the market rate project?

Acquisition & rehabilitation of existing rental units:

- Cannot obtain RHNA credits for the affordable units.
- Does not add units to the housing inventory.

Issues for Consideration

Legal limits on Inclusionary Housing Programs:

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

Inclusionary Housing obligations provide the City with the flexibility to establish development standards that the Section 65915 density bonus alone does not provide.

In-lieu fees can be used for a wide variety of affordable housing activities including:

- Assistance to 100% affordable projects
- Contributions to homeless shelters
- Home buyer programs
- Rehabilitation loans

Policy Decisions for the City Council

The minimum project size that will trigger the requirement.

Target income and affordability standards.

Covenant periods.

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