ATTACHMENT 1

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MEMORANDUM

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To: Jennifer Le, Director of Economic and Development Services
City of Costa Mesa

From: Kathleen Head

Date: July 11, 2023

Subject: Inclusionary Housing: Policy & Implementation Recommendations

Keyser Marston Associates, Inc. (KMA) was engaged by the City of Costa Mesa (City) to assist in creating an Inclusionary Housing program. As the first step in this process, KMA prepared the accompanying *Inclusionary Housing: Financial Evaluation* (Financial Evaluation). Based on the results of the Financial Evaluation, KMA created Inclusionary Housing policy recommendations, which are presented in the following memorandum.

This memorandum is organized as follows:

1. The findings of the Financial Evaluation are summarized.
2. The components of the recommended policies are identified.
3. The recommended implementation package is described.

FINANCIAL EVALUATION FINDINGS

The City's primary goal is to create an Inclusionary Housing program that provides sufficient incentives and benefits to offset the impacts created by the affordable housing requirements being imposed. Based on the results of the Financial Evaluation, KMA identified the following supportable Inclusionary Housing requirements for residential development occurring in defined areas within Costa Mesa.

Supportable Inclusionry Housing Requirements Apartment Development Prototypes		
Area	Low Income Units	Very Low Income Units
North Costa Mesa	19%	12%
Harbor Mixed Use	11%	7%
Mesa West	6%	4%
19 West	8%	4%
SoBECA	6%	3%
Corridors	12%	7%

Supportable Inclusionary Housing Requirements Ownership Housing Development	
Area	Moderate Income Units
North Costa Mesa	9.8%
Harbor Mixed Use	2.5%
Mesa West	6.1%
19 West	1.7%
SoBECA	3.5%
Corridors	N/A

POLICY RECOMMENDATIONS

The Inclusionary Housing policy recommendations cover the following topics:

1. The minimum residential project size that will trigger an Inclusionary Housing obligation.

2. The income and affordability requirements that will be applied to apartment and ownership housing developments.

3. The covenant periods under which the income and affordability standards should be imposed for apartment and ownership housing developments.

4. Alternative methods for fulfilling the Inclusionary Housing obligations.

5. Implementation activities that should be undertaken by the City.

Threshold Project Size

The majority of Inclusionary Housing programs in California include a threshold project size below which projects are not subject to the affordable housing production requirements. Common thresholds fall between three and 10 units. KMA recommends that the City set the threshold at five units, which is the standard applied by California Government Code Section 65915 et seq. (Section 65915).

Income and Affordability Standards

The Financial Evaluation provides context for the on-site production requirements that can reasonably be imposed on new residential development. However, the results of the Financial Evaluation are only meant to serve as a tool to assist the City in establishing the Inclusionary Housing requirements that will be imposed.

APARTMENT DEVELOPMENT

Inclusionary Housing Production Requirements

Based on the results of the Financial evaluation, KMA recommends that following menu of Inclusionary Housing production options be offered to apartment developers:

Recommended Inclusionary Housing Production Options Apartment Development					
Density Range	Low Income Units	+	Very Low Income Units	=	Total Obligation
0 to 39 Units Per Acre	6%	+	0%	=	6%
40 to 59 Units Per Acre					
Low Income Only	11%	+	0%	=	11%
Very Low Income Only	0%	+	7%	=	7%
Low & Very Low Income	6%	+	3%	=	9%
60+ Units Per Acre					
Low Income Only	19%	+	0%	=	19%
Very Low Income Only	0%	+	12%	=	12%
Low & Very Low Income	11%	+	5%	=	16%

It should be noted that developers commonly use the Section 65915 density bonus to mitigate the impacts created by the imposition of Inclusionary Housing requirements. Based on the structure of Section 65915 in most cases a developer will choose to fulfill the affordable housing requirement with very low income units. Very low income units must be counted towards the fulfillment of the City's low income requirement.[1]

Affordable Rent Calculation Methodology

1. The low income rents should be based on 80% of area median income (AMI). This percentage of AMI is based on the standard imposed in Assembly Bill 1505, which was adopted by the State Legislature in 2017.

2. The affordable rents used in Section 65915 density bonus projects are required to be based on the household income standards imposed by California Health and Safety Code (H&SC) Section 50053.

[1] Based on the First District Court of Appeal ruling in *Latinos Unidos del Valle de Napa y Solano v. County of Napa,* 217 Cal. App. 4th 1160 (*Napa*).

Ownership Housing Development

The KMA analysis of ownership housing developments identified Affordability Gaps that range from $557,000 to $745,000 per moderate income unit. Given the magnitude of the gaps, KMA offers the following recommendations:

1. Developers should be permitted to pay a fee in lieu of producing affordable housing units.

2. 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.

Covenant Periods

Apartment Development

KMA recommends that the covenants for the Inclusionary Housing apartment units should remain in place for as long as the property is developed with a residential use, but for not less than 55 years. Following the 55-year term, the covenant should only be removed if at some point the property is rezoned and subsequently put to a non-residential use.

Ownership Housing Development

As discussed previously, KMA recommends that developers be permitted to pay a fee in lieu of producing income restricted ownership housing units. However, if a developer chooses to produce the affordable units, the covenant period should be set at one cumulative 45-year period. Within that one 45-year period the home must be sold and resold to moderate income households at the then current Affordable Sales Price.

Inclusionary Housing Fulfillment Options

AB 1505 includes a provision that requires jurisdictions to provide alternative means of complying with the income and affordability requirements imposed by an Inclusionary

Housing program.[2] By right, developers should be allowed to fulfill a project's Inclusionary Housing obligations on site within a proposed market rate project. In addition, KMA recommends that the following options be offered under specified circumstances.

In-lieu Fee Payment

1. An in-lieu fee should be allowed to be paid for any fraction of an affordable unit that is required to be produced under the Inclusionary Housing requirements.

2. The following in-lieu fee payment options should be offered to proposed apartment developments:

   a. KMA recommends that an in-lieu fee payment be allowed by right for apartment developments with 100 or fewer units.

   b. As a baseline, apartment developments with more than 100 units should be required to produce the required affordable housing units. However, the City Council should be provided with the discretion to allow an in-lieu fee to be paid for apartment developments with more than 100 units if the obligation is deemed to create an extreme financial hardship.

3. Ownership housing developments of any size should be provided with the option to pay a fee in lieu of producing affordable units.

Alternative Means of Producing Affordable Housing Units

KMA recommends against providing an off-site production option as a fulfillment alternative for apartment developments. It is our opinion that, from a public policy perspective, it is better to integrate market rate and affordable rental units into the same project.

[2] AB 1505 only applies the restrictions imposed on apartment development. However, the provision of alternative means of compliance is a best practice and is commonly provided to ownership housing development as well.

KMA recommends that the developers of ownership housing developments be permitted to fulfill the Inclusionary Housing obligations with affordable apartment units. In those cases the developer should be required to:

1. Intersperse the apartments within the ownership housing development or to create two separate parcels within a development site; and

2. Construct the affordable apartment units concurrently with the market rate ownership housing units.

IMPLEMENTATION RECOMMENDATIONS

As part of the implementation process for the Inclusionary Housing program KMA recommends that the City take the following actions:

Marketing Requirements

The City wishes to focus the marketing effort in a manner that focuses on households that live and/or work in Costa Mesa. To that end, the Inclusionary Housing regulations should require developers to prominently advertise the affordable housing units in local newspapers. In addition, information pertaining to affordable housing units that are being developed and marketed will be placed on the City's website.

Section 65915 Density Bonus

The City's Section 65915 density bonus ordinance is included in Chapter IX of the Costa Mesa Municipal Code (Chapter 9), and it was last amended in 2007. The City is currently in the process of amending the density bonus ordinance to reflect changes the State Legislature has made during the intervening period. Until the update is codified, State law will automatically prevail over any inconsistencies between State law and Chapter 9.

Affordable Housing Regulations

The following Inclusionary Housing Ordinance regulations documents should be created:

1. Affordable Apartment Regulations; and

2. Affordable Ownership Housing Regulations: Developer Requirements.

Inclusionary Housing Program Updates

The Inclusionary Housing program should be updated at regular intervals:

1. The entire program should be re-evaluated at least every five years. The City may wish to consider a shorter period for the first program re-evaluation.

2. To allow in-lieu fees to keep pace with changes in the market place during the intervening periods, the in-lieu fees should continue to be adjusted each year based on the percentage change in new home prices in Orange County.

Staffing Plan

A staffing plan should be created for managing the development process and the ongoing monitoring of the affordable units once they are built.

SUMMARY

The preceding memorandum presented KMA's policy recommendations related to creating an Inclusionary Housing program. The recommended affordable housing requirements are based on the results of the accompanying Financial Evaluation, and on an evaluation of fulfillment options that can be made available to the developers of market rate residential projects.