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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: November 6, 2023

Subject: Inclusionary Housing Financial Evaluation: Supplemental Analysis

Keyser Marston Associates, Inc. (KMA) prepared an Inclusionary Housing: Financial Evaluation (Financial Evaluation) report dated July 11, 2023. The purpose of the Financial Evaluation was to assess the viability of enacting an Inclusionary Housing program in conjunction with zoning code amendments that will expand housing development opportunities in overlay areas defined in the approved Sixth Cycle Housing Element (Housing Element).

BACKGROUND

The Financial Evaluation analyzed the impact the proposed zoning code amendments could potentially have on the values supported by properties located in the overlay areas. It is the City's goal to create Inclusionary Housing obligations that are offset by incentives and benefits provided by the City.

The Financial Evaluation included an analysis of a prototype apartment development based on a property north of the 405 freeway that is identified as an opportunity site in the Housing Element. The property is zoned for business park development and is currently used as a surface parking lot. Based on a prototype developed at a density of 60 units per acre, the Financial Evaluation concluded that the following Inclusionary Housing requirements could be supported:

Supportable Inclusionary Housing Requirements 60 Unit Per Acre Prototype Apartment Development Business Park Zoning – Current Surface Parking Lot	
Low Income	19%
OR	
Very Low Income	12%

Notably, the Financial Evaluation also analyzed a 60 unit per acre apartment development prototype based on a property that is currently developed with an auto related use. The results of that analysis are summarized in the following table:

Supportable Inclusionary Housing Requirements 60 Unit Per Acre Prototype Apartment Development Existing Auto Related Use	
Low Income	12%
OR	
Very Low Income	7%

It is important to understand that the existing land use represents the only variation between the two prototypes identified above. As can be seen, this variable creates a significant impact on the Inclusionary Housing requirements that can be supported.

SUPPLEMENTAL ANALYSES

City of Costa Mesa (City) staff and KMA participated in several meetings with developers active in apartment development to discuss the results of the Financial Evaluation. Following these meetings City staff requested that KMA prepare the supplemental analyses to evaluate the following issues:

1. The large number of industrial and office properties that are located in the overlay areas;

2. Apartment development densities identified as optimal by the developer participants;
and
3. Parking configurations.

Prototype Assumptions

KMA tested the following prototypes in this supplemental analysis:

1. Property characteristics:
 - a. The site size is set at four acres.
 - b. The property is currently zoned for industrial or office development.
2. The following density alternatives were evaluated:
 - a. 60 units per acre;
 - b. 75 units per acre; and
 - c. 90 units per acre.
3. The parking configuration assumptions are:
 - a. For the 60 unit per acre and 75 unit per acre alternatives it was assumed that the project is a wrap style served by above ground parking spaces.
 - b. For the 90 unit per acre scenario the parking was assumed to be provided in one level of subterranean parking.

Key Findings

KMA reached the following conclusions based on the results of the supplemental analysis:

60 UNIT PER ACRE ALTERNATIVE

The estimated property acquisition costs for industrial/office properties are only slightly lower than the land value supported by apartment development at a density of 60 units per acre.

This limits the potential for imposing an Inclusionary Housing obligation to an approximately 4% low income standard.

75 UNIT PER ACRE ALTERNATIVE

The developers indicated that a wrap style apartment development, at a density in the range of 75 units per acre, is the most viable project type under current market and financial conditions. This represents a 25% density bonus if it is assumed that the base zoning density is set at 60 units per acre.

KMA evaluated the following income and affordability standards:

1. A scenario that sets low income rents at the 80% of area median income (AMI) standard applied by Assembly Bill 1505:
 - a. It would be necessary for a City to create a local density bonus to allow the 80% of AMI standard to be applied.
 - b. The analysis supports an 11% low income requirement.
2. A scenario based on the 7% very low income requirement imposed by the Government Code Section 65915 et seq. (Section 65915) density bonus.

90 UNIT PER ACRE ALTERNATIVE

Ninety (90) units per acre is the maximum Section 65915 density bonus that can be achieved if the base zoning is set at 60 units per acre. Factors that influence the viability of this alternative are:

1. The cost premiums associated with a more intense construction type;
2. The need to provide subterranean parking; and
3. The Section 65915 requirement to set aside 15% of the base zoning units at very low income.

The combination of these factors currently renders this alternative less financially viable than the 75 unit per acre alternative.

CONCLUSIONS

It is the City's goal to create an Inclusionary Housing program that provides sufficient incentives to create opportunities for new housing development to occur. To that end, it is necessary to create benefits and incentives that offset the financial impacts created by the imposition of affordable housing requirements. It is KMA's practice to take a conservative approach in identifying the affordable housing requirements that can be supported.

The preceding supplemental analysis is based on overlay areas proposed to be rezoned to allow residential development at a density of 60 units per acre. Based on market and financial conditions it should be anticipated that activity will be focused on apartment development.

As discussed previously in this analysis, the existing land use creates a significant impact on the Inclusionary Housing requirements that can be supported. The differences are summarized in the following table:

Supportable Inclusionary Housing Requirements 60 Units Per Acre Base Zoning Alternatives Apartment Development			
Existing Land Use	Low Income	OR	Very Low Income
Vacant Business Park Land	19%		12%
Existing Auto Related Use	12%		7%
Industrial/Office Property	4%		NA

The KMA supplemental analysis concluded that density in the range of 75 units per acre currently provides the strongest opportunity for maximizing the Inclusionary Housing requirements while not constraining housing development opportunities. The supportable requirements are:

1. An 11% low income requirement assuming the income and affordability standards are set at 80% of AMI; or
2. A 7% very low income requirement, which comports with the requirements imposed by the Section 65915 density bonus.

RECOMMENDATIONS

Based on the results of the July 11, 2023 Financial Evaluation and this supplemental analysis memorandum, KMA recommends that the following Inclusionary Housing requirements be imposed:

Supportable Inclusionary Housing Requirements 60 Units Per Acre Base Zoning Alternatives Apartment Development			
Overlay Areas	Low Income	OR	Very Low Income
Density at 60 Units Per Acre or Greater	11%		7%
Density at Less than 60 Units Per Acre	6%		4%