



City of Costa Mesa

Agenda Report

77 Fair Drive
Costa Mesa, CA 92626

Item #: 24-229

Meeting Date: 06/18/2024

TITLE: FEE RESOLUTION TO ESTABLISH THE AFFORDABLE HOUSING IN-LIEU FEE SCHEDULE

DEPARTMENT: ECONOMIC AND DEVELOPMENT SERVICES DEPARTMENT/PLANNING DIVISION

PRESENTED BY: AMBER GREGG, CONTRACT PLANNER

CONTACT INFORMATION: AMBER GREGG, CONTRACT PLANNER, (714) 754-5617

RECOMMENDATION:

Staff recommends the City Council:

1. Find that the project is categorically exempt from the California Environmental Quality Act (CEQA), Section 15061(b)(3) ("General Rule").
2. Adopt a fee resolution establishing the affordable housing in-lieu fee.

BACKGROUND:

The City is currently considering, for second reading, the adoption of an Affordable Housing Ordinance. The Affordable Housing Ordinance would require, among other regulations, that new rental housing projects in the City with 50 or more units provide a percentage of its housing units as "affordable" units for low or very low-income households. As the Ordinance is currently drafted, an applicant of a rental housing project can fulfill their affordable obligation with onsite production of affordable rental units, offsite production of affordable rental units, dedication of land to the City, or by payment of in-lieu fees.

At the April 2, 2024, City Council meeting, the City Council considered an in-lieu fee resolution to establish an affordable housing in-lieu fee schedule. At the meeting, the City Council directed staff to defer the in-lieu fee resolution to a later date. The April 2, 2024, City Council report and video are linked below:

April 2, 2024, City Council Agenda Report (also provided as Attachment 2):

<https://costamesa.legistar.com/View.ashx?M=F&ID=12813101&GUID=0833EA65-75E4-4457-91C3-6C527B94C87C>

April 2, 2024, City Council Video:

https://costamesa.granicus.com/player/clip/4125?view_id=14&redirect=true

April 2, 2024, City Council minutes are provided as Attachment 3.

DISCUSSION***City Council Study Session on Proposed In-Lieu Fee Amounts***

As part of their first reading of the Affordable Housing Ordinance discussions, 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 proposed in-lieu fee analysis was presented to the City Council at a study session on February 27, 2024. During the study session, staff and Keyser Marston Associates (KMA) presented the proposed fee schedule as well as an explanation of the fee calculations. The City Council also received public comments, asked staff and KMA follow-up questions, and provided their comments on the proposed fees and overall vision for the proposed Affordable Housing Ordinance.

The February 27, 2024 City Council study session agenda report, meeting video, and public comments are included in the links below:

- February 27, 2024 City Council Agenda Report:
<https://costamesa.legistar.com/View.ashx?M=F&ID=12707839&GUID=649FCC95-B510-4D3F-92E7-9C400FFDF63>
- February 27, 2024 City Council Meeting Video:
https://costamesa.granicus.com/player/clip/4093?view_id=14&redirect=true
- February 27, 2024 City Council Public Comments:
<https://costamesa.legistar.com/View.ashx?M=E3&ID=1171565&GUID=B7C4B0DD-7AD7-4ADC-B8C3-392422409AF7>

Public comments as well as the City Council's feedback from the February 27, 2024 study session expressed the need to ensure that Costa Mesa is competitive with nearby cities, can attract housing developers for the creation of housing in the community, and the Affordable Housing Ordinance should not result in an impediment to the production of housing in the City. Discussions included comparing the City's proposed in-lieu fee amounts with the City of Santa Ana (who has seen success with their affordable housing production program) and concerns that the City's proposed fee amounts were too high. The City's expert housing consultant, KMA, clarified that Santa Ana did not determine their in-lieu fee amounts based on a fee study or financial impact analysis; and therefore, is not equivalent to their onsite production requirements. In contrast, Costa Mesa's proposed fee amounts are derived from the pending Affordable Housing Ordinance requirements so that the fees are equivalent to producing the affordable units onsite. While the City Council could consider lowering the in-lieu fee amounts below equivalency to producing the onsite units, doing so would possibly result in housing developers of more than 50 rental units choosing to pay the in-lieu fees rather than developing the affordable units.

Fee Resolution to Establish the Affordable Housing In-Lieu Fee Amounts

Included with this Agenda Report is a fee resolution to adopt the in-lieu fee amounts as shown in Table 1 below. The proposed fee amounts are based on the proposed Affordable Housing Ordinance requirement set aside percentages.

Table 1 – Proposed Affordable Housing In-Lieu Fee Amounts

In-Lieu Fee Payment Schedule Per Square Foot of Total Leasable Area in an Apartment Development	
Developments greater than 60 units per acre	Developments less than 60 units per acre
\$19.50 PSF	\$13.80 PSF

Previously, the proposed in-lieu fee payment schedule provided fee amounts for developments of 15 units to 21+ units; however, modifications to the Affordable Housing Ordinance now establishes the applicability threshold to developments with 50 dwelling units or more. Due to this, only one fee amount for each category is proposed. In addition, the previous in-lieu fee payment schedule included an “ownership housing development” fee category which has also been eliminated pursuant to the ownership housing development applicability removal from the Ordinance.

The fee resolution also includes a schedule of fractional in-lieu fee payments for developers that choose this option for fulfilling an obligation to produce a fraction of an Inclusionary Unit. The fractional in-lieu fee schedule is included in Attachment 2.

Comparison of Other Cities In-Lieu Fee Amounts

To provide the City Council with additional comparisons of other cities’ affordable housing in-lieu fee amounts, refer to Table 2. As shown in the Table, there is no standard to establish an affordable housing in-lieu fee amount or fee structure. As shown in the table below, the in-lieu fees could be based on a sliding scale, flat fee per square foot, incremental increase over time, and/or a formula based on certain variables. The City of Encinitas more recently increased their fees from \$20 per square foot to \$23.79 per square foot. Encinitas also adjusts their fee administratively based on the percentage change in the most current Engineering News Record Construction Cost Index for the Los Angeles region. The City of San Diego adopted a program that included an incremental increase to their in-lieu fee amounts each fiscal year with the current fee set at \$25 per square foot.

Table 2 – Comparison of Other Cities In-Lieu Fee Amounts

Santa Ana	<ul style="list-style-type: none"> • 5-9 Units: \$6 per sq. ft. • 10-14 Units: \$9 per sq. ft. • 15-19 Units: \$12 per sq. ft. • 20+ Units: \$15 per sq. ft. • Only applies to changes in land use and zoning designations. • Set Aside: 5-15% Rental, and 5% Ownership • Affordability Requirement: <ul style="list-style-type: none"> ○ 15% Low, or 10% Very Low, or 5% at Extremely Low, or ○ 5% Low + 3% Very Low + 2% Extremely Low
Encinitas	<ul style="list-style-type: none"> • 1 – 6 units: sliding scale¹ • 7+ units: \$23.79 per sq. ft.

	<ul style="list-style-type: none"> Affordability Requirement: <ul style="list-style-type: none"> 10% Very Low or 15% Low
Irvine	<ul style="list-style-type: none"> Formula based and calculated per project² Affordability Requirement: <ul style="list-style-type: none"> 5% Very Low + 5% Low + 5% Moderate
Long Beach	<ul style="list-style-type: none"> Rental: \$38 per sq. ft. Ownership: \$29.10 per sq. ft. Affordability Requirement: <ul style="list-style-type: none"> 11% Very Low – Rental 10% Moderate – Ownership
Oceanside	<ul style="list-style-type: none"> 2023 in-lieu fee set at \$15 per sq. ft. 2024 in-lieu fee increased to \$20 per sq. ft. Affordability Requirement: <ul style="list-style-type: none"> 10% Low – Rental 10% Moderate – Ownership
Santa Monica	<ul style="list-style-type: none"> Rental: \$35.70 per sq. ft. Ownership: \$41.70 per sq. ft. Affordability Requirement: <ul style="list-style-type: none"> 5% to 30% Very Low, Low, and Moderate
San Diego	<ul style="list-style-type: none"> Incremental increase from July 1, 2020 through June 30, 2024³ 2024 in-lieu fee increased to \$25 per sq. ft. Affordability Requirement: <ul style="list-style-type: none"> 10% Very Low or Low – Rental 10 to 15% Moderate – Ownership
<p>¹ Sliding scale is based on a percentage of the adopted in-lieu fee amount depending on the number of units. For example, one unit project would be required to pay 14% of the in-lieu fee dollar amount.</p> <p>² Formula is based on land value, density, and percentage share of cost related to affordable units not being produced.</p> <p>³ Prior to July 1, 2020, the in-lieu fee was established at \$12.73 per sq. ft. and has increased every fiscal year (2021 - \$15.18, 2022 - \$17.64, 2023 – \$20.09)</p>	

ALTERNATIVES:

The City Council may adopt the fee resolution, modify the proposed fee schedule, or not adopt the fee resolution.

The City Council may also consider implementing the in-lieu fee schedule incrementally, similar to the City of San Diego. The City of San Diego initially set the in-lieu fee at a lower amount and over a five-year period, increased the fee to its eventual rate. The fee increased \$12.27 over the five-year period. The fee is then updated annually based on the annual increase in the Construction Costs Index (CCI) published by Engineering News Record for Los Angeles, or similar construction industry index selected by the City Manager if the CCI index is discontinued. The Council could consider initially setting the fee at a lower rate and establish a schedule for increases over any specified period of time until the preferred maximum fee amount is met. For example, the Council may evaluate a fee of \$12 in year one, with increases over a 10-year period to an eventual amount of \$19.50 per applicable square foot (as currently proposed for development with 60 dwelling units or more per acre) and include an annual

update to the fee based on changes in the Orange County home values or similar value related industry index.

FISCAL REVIEW:

Should the City Council adopt the in-lieu housing fee resolution, the City could potentially receive revenue from payment of fees that would be deposited into a Housing Trust Fund (Fund 226) to support and promote affordable housing programs in the City, including the administration of the City's Affordable Housing Program.

LEGAL REVIEW:

The proposed fee resolution, and this report have been prepared in conjunction with and approved by the City Attorney's Office.

PUBLIC NOTICE:

Pursuant to Government Code Section 66016, the proposed fee schedule and fee study was made available to the public 15 days prior to the June 18, 2024, City Council meeting.

Public comments received prior to the June 18, 2024, City Council meeting may be viewed at this link: [CITY OF COSTA MESA - Calendar \(legistar.com\)](https://legistar.com/CITY_OF_COSTA_MESA).

CITY COUNCIL GOALS AND PRIORITIES:

This item supports the City Council's Goal to *Diversify, Stabilize, and Increase Housing to Reflect Community Needs* in that the adoption of an Affordable Housing Ordinance, and subsequent in-lieu fee, assists in achieving the City's RHNA for the very-low-, low-, and moderate-income categories, coupled with the other Housing Element programs intended to remove or reduce existing barriers and constraints to market-rate housing developments.

CONCLUSION:

A component of an Affordable Housing Ordinance is the establishment of an in-lieu fee for applicants wishing to fulfill their affordable housing requirements by paying an in-lieu fee rather than providing the affordable units on-site. The proposed fees are based on the KMA analysis, including the set aside percentages previously considered by the City Council. However, the City Council may decide alternative fee amounts may be more appropriate at this time. If the proposed fees are not approved, staff seeks direction from the City Council as to what the In-lieu housing fee schedule should be.