CITY OF COSTA MESA

REGULAR CITY COUNCIL AND SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY, AND HOUSING AUTHORITY*

Agenda

Tuesday, May 16, 2023	**6:00 PM**	**City Hall Community Room 77 Fair Drive**

SPECIAL JOINT STUDY SESSION MEETING OF THE COSTA MESA CITY COUNCIL AND PLANNING COMMISSION

Planning Commission Vice Chair Toler will be attending the meeting via Zoom Webinar from:
Seattle Marriott Bellevue
200 110th Avenue NE
Bellevue, Washington, 98004

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SPECIAL JOINT STUDY SESSION MEETING OF THE CITY COUNCIL AND PLANNING COMMISSION

MAY 16, 2023 – 6:00 P.M.

CITY COUNCIL:

Mayor John Stephens, Mayor Pro Tem Jeffrey Harlan, Council Members Andrea Marr, Manuel Chavez, Loren Gameros, Arlis Reynolds, and Don Harper.

PLANNING COMMISSIONERS:

Chair Adam Ereth, Vice Chair Russell Toler, Commissioners Johnny Rojas, Angely Andrade Vallarta, Tim Taber, Jon Zich, and Jimmy Vivar

CALL TO ORDER

ROLL CALL

PUBLIC COMMENTS – Comments are limited to 2 minutes, or as otherwise directed.

STUDY SESSION ITEM:

1. **JOINT STUDY SESSION REGARDING INCLUSIONARY HOUSING PROGRAM OVERVIEW AND POLICY DISCUSSION** 23-1201

   RECOMMENDATION:

   Staff recommends the City Council and Planning Commission receive the staff presentation, provide feedback, and provide direction regarding a potential inclusionary housing ordinance for Planning Commission and City Council consideration.

   Attachments: 1. Housing and Community Development Letter.pdf
   2. Affordable Housing Rents and Incomes.pdf
   3. Density Bonus Chart.pdf
   4. OC Inclusionary Housing Comparison.pdf
   5. KMA Analysis Prototypes.pdf
   6. KMA Prelim Findings_Exec Sum.pdf
   7. Draft Ordinance Framework.pdf

ADJOURNMENT

77 Fair Drive
Costa Mesa, CA 92626

CITY OF COSTA MESA

Agenda Report

File #: 23-1201 **Meeting Date:** 5/16/2023

TITLE:

JOINT STUDY SESSION REGARDING INCLUSIONARY HOUSING PROGRAM OVERVIEW AND POLICY DISCUSSION

DEPARTMENT: ECONOMIC AND DEVELOPMENT SERVICES DEPARTMENT/PLANNING DIVISION

PRESENTED BY: JENNIFER LE, ECONOMIC AND DEVELOPMENT SERVICES DIRECTOR AND NANCY HUYNH, SENIOR PLANNER

CONTACT INFORMATION: NANCY HUYNH, SENIOR PLANNER, (714) 754-5609

RECOMMENDATION:

Staff recommends the City Council and Planning Commission receive the staff presentation, provide feedback, and provide direction regarding a potential inclusionary housing ordinance for Planning Commission and City Council consideration.

BACKGROUND:

Housing Element and Regional Housing Needs Assessment (RHNA)

The Housing Element is a chapter of the City's General Plan required by State law to be updated every eight years. The purpose of the Housing Element is to evaluate community housing needs and identify a high-level strategy for addressing the City's needs over the eight-year planning cycle. Each eight-year planning cycle, the City is allocated a specific number of housing units including affordable units called the Regional Housing Needs Allocation (RHNA) that the City needs to plan for which is determined by the State and the Southern California Associations of Governments (SCAG). The City's RHNA allocation, which is intended to reflect the City's "fair share" of the regional housing need, is 11,760 units. The allocated housing units are divided into household income categories, i.e., very low income, low income, moderate income, and above moderate income, which are based on the most current Area Median Income (AMI) for Orange County; refer to Table 1 below for the City's 2021-2029 RHNA.

Table 1 - City of Costa Mesa 2021-2029 RHNA

Very Low (0-50% AMI)	2,919 Units
Low Income (51-80% AMI)	1,794 Units
Moderate Income (81-120% AMI)	2,088 Units
Above Moderate Income (120% or more AMI)	4,959 Units
Total RHNA	**11,760 Units**

Although the City is not required to construct these units, the City is required per State law to plan, zone and otherwise create the policy framework to accommodate the RHNA allocation. In addition, the City is required to report annually to the State as to its progress in implementing its Housing Element programs and progress toward achieving the RHNA allocation. As such, the Housing Element includes the City's housing goals, policies, and implementation actions (referred to as Housing Element "programs").

The City began preparation of its Housing Element in October 2020 and held its first community outreach meeting in November 2020. Following several community meetings, Planning Commission and City Council study sessions, and public review of the Draft Housing Element, the Housing Element was submitted to the State for certification and subsequently adopted by the City Council on February 1, 2022. Following revisions that were required in order to respond to State comments and requests, the City Council re-adopted the 2021-2029 6th Cycle Housing Element on November 15, 2022. On May 9, 2023, the State issued a letter accepting and approving the City's Housing Element as being in compliance with State Housing Element law (see Attachment 1).

The Housing Element includes over 40 programs that work together to form a cohesive and comprehensive housing strategy to address housing needs. For example, the City's housing programs call for re-zoning certain housing opportunity sites and updating the City's local urban plans and specific plans for the areas of the City located north of the I-405 and along other major City commercial and industrial corridors. The required rezoning and updates are for the purpose of creating new housing opportunities and increasing housing supply in the City. Other programs call for the City to evaluate and remove regulatory constraints that increase housing development costs or otherwise discourage housing projects from moving forward. Examples of potential housing constraints for cities include higher than typical development fees, residential parking requirements, or procedural requirements that contribute to longer processing times or approval uncertainty for housing projects. Lastly, programs call for City actions that focus on regulations, incentives, or funding programs that directly preserve or create housing that is affordable to all segments of the Costa Mesa community.

One of the Housing Element goals (Housing Goal #2) is to "facilitate the creation and availability of housing for residents at all income levels and for those with special housing needs." In order to accomplish this goal, the Housing Element identifies Program 2A which calls for the City to consider adoption of an inclusionary housing ordinance. An inclusionary housing ordinance would generally require new housing projects in the City to provide a certain percentage of its housing units as affordable units to moderate, low, and/or very low-income households. The City must make efforts to implement this program within one year of Housing Element adoption in order to maintain compliance with State law. Adopting such an Ordinance would meet this requirement.

Community Demographics and Need for Affordable Housing

In planning for and addressing the City's housing needs, staff considered the City's existing housing stock and community demographics (e.g., population, employment, economics, and household characteristics) as well as projected future growth trends. The demographic analysis was included in Chapter 2 of the City's Housing Element, referred to as the Community Profile. The findings of the Community Profile identify demographic trends, segments of the community most vulnerable to housing instability, and should inform policy decisions related to inclusionary housing.

- **Lower Income Households:** Approximately 47-percent of the Costa Mesa community earn a lower income and approximately 29-percent of the community qualify for very low or extremely low-income housing. Lower income households cannot afford to own or rent in Costa Mesa without experiencing overpayment. This indicates that the production of and access to affordable housing options for lower income households should be a priority for housing policy.

- **Housing Cost Burdens/Overpayment:** Affordable housing is defined in State law as not paying more than 30-percent of a household's gross income on housing costs including utilities. Yet nearly half of renters in Costa Mesa experience housing cost burdens that exceed 30-percent of gross income and over a quarter of renters experience severe housing cost burdens that exceed 50-percent of gross income. Overpayment is an indicator of the lack of affordable housing options and high housing costs compared to household incomes.

  For context on what is considered an affordable rent or purchase price, please refer to the tables in Attachment 2. These tables show the household income limit for the various income categories (very low, low, moderate income) and what would be considered an affordable rent or purchase price for housing for each household income level.

  As shown in the tables, a household of four with an income of $108,400 would be considered "low-income". An affordable rental price for a two-bedroom apartment for a low-income household is $2,003. However, the average rent in Costa Mesa for a two-bedroom unit is $2,649 (2020).

  For ownership housing, a household of four with an income of $142,900 is considered moderate income. An affordable sales price for a for sale two-bedroom unit is $439,900. Yet, the median home price for ownership housing in Costa Mesa is $1.3 million (2022).

- **Low Vacancy Rates:** Costa Mesa has a low housing vacancy rate which indicates that there is a high demand for housing but low supply to fulfill the community's housing needs. With high demand and low supply, rental and ownership housing prices tend to be higher and thus is one of the factors contributing to the lack of affordable housing options in Costa Mesa. Costa Mesa's housing stock was primarily built prior to 1990 with almost a quarter of the stock built around the time the City was incorporated in the 1950's. A little over two-percent of the housing stock in the City was built after 2010. The lack of newer housing stock has contributed to the low supply and high rental and housing costs.

- **Age Characteristics:** Housing needs are influenced by the unique requirements and preferences of certain age groups. Costa Mesa's population is showing aging trends. The population aged 65 and over experienced the most growth in Costa Mesa between 2010 and 2018. An aging population could result in changing needs and demand for different housing types. Seniors tend to have less flexible or fixed incomes. Therefore, with the rising prices in rental and ownership housing costs, affordable housing options for seniors should be a priority.

  While the population has been aging in recent years, young adults 20 to 34 years represent the largest age group in Costa Mesa at over a quarter of the City's population. Like the senior age group, young adults tend to also have comparatively lower incomes and therefore tend to favor apartments, or where feasible smaller, more affordable, single-family units, townhomes, or condominiums.

City Council Housing Goals

Concurrently with the Housing Element efforts, the City Council adopted a Strategic Plan in 2021, identifying five key goals to address specific community issues and needs. One of the Council's Strategic Plan goals is to ***"diversify, stabilize, and increase housing to reflect community needs."*** To address this goal, the City Council also identified several strategic objectives and priorities. One of the Council's identified priorities included considering a draft inclusionary housing ordinance.

As such, staff retained an expert consultant, Keyser Marston Associates Inc. (KMA), to evaluate and make policy recommendations for a potential inclusionary housing ordinance, including the affordability percentage requirement, the potential for an in-lieu fee option, and other factors described in greater detail in this report.

Study Session

This study session is intended to provide an overview of inclusionary housing policy, including a summary of the major components of an inclusionary ordinance, legal requirements, compliance options, and a discussion of policy considerations and industry best practices including inclusionary requirements adopted by other local cities.

In addition, at the study session we will discuss the scope of KMA's financial evaluation which is currently underway, KMA's initial findings based on its base zoning prototype analysis for both rental and ownership products, and pending analysis scenarios that are being based on the re-zoning scenarios described in the City's adopted Housing Element.

Staff is seeking the Planning Commission and City Council's initial feedback and will ultimately prepare a draft ordinance for Planning Commission recommendation to the City Council, if so directed.

ANALYSIS:

Inclusionary Housing Overview

For over thirty years, local California jurisdictions have implemented inclusionary housing programs to increase the supply of affordable housing for low- and moderate-income households. Presently, over 170 California cities have adopted inclusionary housing programs including eight in Orange County. Inclusionary housing policies require developers to reserve a percentage of new housing units for low- or moderate-income households within new residential developments. Residents of the reserved units are subject to income eligibility requirements. Inclusionary housing requirements can be applied to new residential for-sale (ownership) projects as well as rental projects.

Inclusionary housing programs offer multiple benefits for communities seeking to increase housing affordability and develop diverse neighborhoods which include increased housing options for lower income households, helping cities achieve RHNA goals, and reducing vehicle miles traveled and greenhouse gas emissions by locating affordable housing options closer to places of employment. Inclusionary programs are one tool among many that cities can utilize to increase the supply of affordable housing units.

Legal Requirements

During the past decade, inclusionary housing programs have been subject to review by both the California Supreme Court and State legislature. In 2015, the California Supreme Court ruled that inclusionary housing programs are a “valid exercise of a jurisdictions zoning powers” (California Building Industry v. City of San Jose). Furthermore, Assembly Bill (AB) 1505, which was adopted in 2017, reaffirmed the authority of local jurisdictions to include rental units within inclusionary ordinance requirements and added the requirement for the State’s Housing and Community Development Department (HCD) to review an inclusionary ordinance for “economic feasibility”. HCD’s review is required in order to confirm that the requirements of an inclusionary housing ordinance would not “unduly constrain the production of housing”.

Since the adoption of AB 1505, local jurisdictions now routinely complete comprehensive financial evaluations to ensure that inclusionary programs consider the strength of the local real estate market and are not “confiscatory”, meaning that the requirements do not deprive a property owner/developer of a reasonable return on investment, or otherwise constitute a “taking” of property by the government.

KMA has been retained to complete this financial evaluation analysis for Costa Mesa which is in progress and would be completed prior to a draft ordinance being prepared and presented to the Planning Commission.

Inclusionary Housing Program Components

There are key provisions that are commonly found in most inclusionary housing programs which include the following:

- **Project Size Threshold:** Inclusionary housing requirements are not usually applicable to all housing development projects. Most programs have a threshold project size standard that would trigger the requirement and this number can vary greatly.

- **Minimum "Set-Aside" Requirement:** The "set-aside" requirements refers to the number of dwelling units in a new housing project required to be set-aside for affordable units.

- **Affordability Level:** The affordability level refers to the targeted household income level, e.g., very-low, low, or moderate-income households, for which the units are required to be affordable.

- **Covenant Period:** Inclusionary housing programs typically require a covenant to ensure the units remain affordable for many years in the future.

- **Alternative Compliance Options:** In California, State law requires that alternative methods of compliance be provided for projects that cannot include affordable housing units onsite. There are four common alternatives to the onsite production of affordable units: in-lieu fees, off-site production, land dedication, and the acquisition and substantial rehabilitation of existing offsite apartment units.

Each of these program components are discussed in greater detail under the "Inclusionary Housing Policy Considerations" heading below.

Density Bonus Programs

Density bonuses are commonly used by housing developers to reduce the financial impacts associated with providing affordable housing. State Government Code section 65915 requires jurisdictions to provide density bonuses based on a sliding scale ranging from five-percent to 50-percent, depending on the proposed affordability level of the proposed units. For example, if a project proposes 15-percent of its units be affordable at the very-low income level, the project could receive a 50-percent density bonus (calculated on the base number of units) under State law. Refer to the table in Attachment 3 of this report which shows the State's density bonus sliding scale.

The City is required to grant a developer's request for the density bonus along with a required number of concessions and/or incentives (unless the City finds that the proposed concession and/or incentive does not result in identifiable and actual cost reductions. The City has the burden of proof in the event the City does not grant a requested concession and/or incentive.) The number of required concessions and/or incentives, as outlined in Government Code Section 65915, is based on a project's percentage of affordable units and the affordability level of each unit; refer to Table 2 below. A concession or incentive under State density bonus law includes: a reduction in development standards or a modification of zoning code requirements such as a reduction in setbacks and/or required parking, waiver or reduction in development fees, or other regulatory incentives or concessions which actually result in identifiable and actual development cost reductions.

Table 2 - Required Number of Concessions/Incentives

Number of Concessions/ Incentives	Very Low Income	Low Income	Moderate Income
1	5%	10%	10%
2	10%	17%	20%
3	15%	24%	30%
4	100%	100%	100%

Although density bonus laws have existed for decades, Costa Mesa has not had a density bonus project since the 1990’s, with the exception of the LUX housing project at 2277 Harbor Boulevard (the former Costa Mesa Motor Inn site), which utilized State density bonus law and included 200 units (of which nine were deed-restricted to be affordable to very low-income households).

Although density bonus requests have not been common in recent decades, density bonuses are discussed in this report because, with the adoption of an inclusionary housing ordinance, it is likely density bonus requests will increase. The reason for the likely increase is that requiring affordable housing units as part of an inclusionary program will automatically make a housing project eligible for a density bonus under State density bonus law.

For example, if the City requires a 10-percent affordable housing set aside as part of its inclusionary policy, a housing project complying with that requirement will automatically be eligible for concessions/incentives and a 32.5-percent density bonus under State law (if the affordable units are provided at the very-low income level; the density bonus percentage applied is lower if the affordable units are provided at a higher income level).

Inclusionary Housing Programs in Orange County Cities

Eight Orange County cities have adopted inclusionary housing ordinances. These cities include: Brea, Huntington Beach, Irvine, Laguna Woods, La Habra, San Clemente, San Juan Capistrano, and Santa Ana. Each city’s program is summarized in Attachment 4 to this Agenda Report.

Generally, each Orange County city adopted the following in their inclusionary housing ordinances:

- Project threshold size ranges between two and 50 units (for both rental and ownership housing) with the average threshold size being approximately 12 units;
- Set-aside percentage between 10 and 15-percent with 15-percent being the most common;
- Affordability level varies and there does not appear to be a common level as affordability level is tailored to each specific jurisdiction and its housing goals and market conditions. However, most set the level differently for rental versus ownership units and require the units to be allocated across multiple income levels with a mix of very low, low, or moderate-income;

- Different covenant periods for rental versus ownership housing including 45 years for ownership and 55 years for rental (20 years is the shortest term as adopted by San Clemente; Irvine adopted 30 years for both housing types);
- Variety of alternative compliance methods including offsite production of units, in-lieu fees, land dedication, or preservation/rehab of existing apartment units; and
- In-lieu fee amounts typically differ for rental versus ownership housing projects and the fee is either a flat rate per square foot or per unit or a formula calculation based on certain variables such as estimated construction cost, land value, and/or cost to produce an affordable unit.

Inclusionary Policy Considerations

There is no one “model” inclusionary housing policy but rather a number of best practices and a range of policy options to consider. Inclusionary housing programs should offer flexibility and be tailored to the unique needs of each community.

A Balanced Policy

Inclusionary requirements should balance the interest of property owners/developers with the public benefit created by the production of affordable housing units. The requirements should not be so burdensome that they would make new housing development infeasible and deprive an owner/developer of a reasonable return on their investment. A requirement that is too stringent given the market conditions in a City could deter and disincentivize housing in that City altogether.

Furthermore, market rate construction is necessary to help drive production of affordable housing. For example, the development of an exclusively affordable project usually requires a combination of tax credits and public agency funding or other subsidies to be feasible or “pencil out”. With the dissolution of the redevelopment agencies in California, funding for housing projects is more limited and opportunities are scarce for such projects. However, affordable housing as a component of a market rate housing development, especially when coupled with a density bonus and/or other zoning changes, helps balance the cost of providing affordable units and makes affordable housing development feasible for private developers to build as part of market rate projects.

In addition, most inclusionary housing programs apply the requirement to housing projects regardless of location in the City to ensure that the policy is implemented equitably and to ensure the affordable units are provided throughout the community and not concentrated in one geographic area. Such a policy creates diverse neighborhoods and incorporates housing options at a range of income levels. However, some cities have adopted different inclusionary requirements for different areas of the City if market conditions are different enough in this areas to warrant that approach.

Inclusionary units are also typically required to be dispersed throughout a housing project, be designed no differently than the market rate units, be constructed concurrently, and have access to the same community amenities. It is typical for inclusionary housing ordinances to include these development standards to ensure the units are equivalent regardless of household income level. In some circumstances, housing developers have asked for flexibility in these requirements to allow for affordable units that meet city-required standards but are not the same as onsite market rate units when this difference supports project feasibility.

Local Context and Financial Feasibility

The key requirements of an inclusionary housing ordinance have been summarized above. However, each of the components must be considered in the local development context for Costa Mesa.

Prior to 2017 and following the enactment of AB 1505 and the ruling in the *California Building Industry Association v. City of San Jose, 61 Cal 4th 435*, some California cities adopted inclusionary housing ordinances based on templates approved by neighboring cities and desired outcomes. However, this “one size fits all” approach led to inconsistencies in the level of success each city could achieve based on its own particular demographics, zoning and opportunities for land use changes. The legislation and court ruling made it an industry best practice and in some cases a mandate that each city conduct a detailed City-specific financial evaluation to drive its own specific policy recommendations to ensure that mandated affordable housing development was economically feasible for both housing developers and the community.

For the City of Costa Mesa, the in-depth financial evaluation performed by KMA is currently underway. The study is evaluating the financial feasibility of imposing Inclusionary Housing requirements on certain housing types and under market conditions experienced in Costa Mesa. To accomplish this, KMA is developing pro forma analyses of prototype residential projects reflective of the Costa Mesa market. (Pro forma is a method of calculating financial results using certain projections and market assumptions). The prototype projects are based on local past or pending residential projects and the residential projects in KMA’s local market surveys. The evaluation analyzes both rental and ownership product types and at varying density levels. The evaluation includes housing development scenarios under both existing base zoning and density provisions allowed by the Costa Mesa General Plan and Municipal Code, as well as under future zoning and density provisions envisioned in the City’s adopted Housing Element. The analysis considers that developers could utilize the density bonus for additional dwelling units (beyond the zone’s established density) and concessions which reduce and offset the cost of constructing inclusionary units and make a higher inclusionary housing requirement more feasible.

Attachment 5 lists the analysis scenarios underway and in summary includes an analysis of a rental unit project developed at the City’s base zoning density of 20 dwelling units per acre and a scenario for the same project under a density bonus scenario of 30 dwelling units per acre. Base scenarios also include an evaluation of ownership housing projects including townhomes, live/work, and condominium projects with varying site size and at base densities ranging from 16 to 25 dwelling units per acre. Scenarios will also be run at densities reflecting State density bonus law.

These scenarios are starting points for the analysis and function as “sensitivity analyses” which are modified and re-run to determine the level of affordable housing requirements that can be supported under existing zoning and current market conditions.

KMA has provided a preliminary executive summary of the outcomes of the base zoning scenarios, see Attachment 6. In summary, it shows that a 10% inclusionary housing requirement for low income units (without a density bonus) may be able to be supported in Costa Mesa under base zoning conditions for rental product types and an eight percent inclusionary housing requirement for moderate income units (without a density bonus) for ownership units. A higher inclusionary set aside and deeper affordability will likely be able to be required under the pending analysis scenarios based on the Housing Element's zoning proposals which is intended to promote and encourage housing.

The analysis scenarios which are pending completion include re-zoning scenarios based on projects which range between 30, 35, 40, 50 and 90 dwelling units per acre. Lower density housing projects are envisioned along the City's major commercial and industrial corridors, with the 90 dwelling unit per acre scenarios envisioned for the areas north of the I-405 where housing projects at higher densities already exist.

This study session will provide an opportunity to share these very preliminary initial findings and recommendations that can help the Planning Commission, City Council, housing advocates, housing developers and the community better understand the factors that can influence a successful inclusionary housing program, and the data required to make those critical decisions. It is also our hope that the study session will provide an opportunity for staff and KMA to receive important feedback regarding any other data, financial pro formas, or housing development scenarios that should be included in the report to help inform future policy decisions.

Project Size Thresholds

Although many inclusionary program components are heavily informed by the financial evaluation, outcomes also respond to local priorities and policy preferences. For example, many cities do not apply their inclusionary requirements to all housing development projects. Most programs have a project threshold size standard that would trigger the inclusionary requirement and this number can vary greatly among city. Some programs do not specify a threshold size and require compliance with the inclusionary program regardless of project size and some do not require onsite production but do require in lieu fees for smaller projects.

The threshold size requirement is important because if it is too high then fewer development projects could trigger the inclusionary housing requirement and therefore not produce affordable units. However, the requirement should not be set at a size that would then encourage projects to develop just under that threshold which would frustrate the goal of inclusionary housing. If the threshold is too low, it could discourage housing projects in the City altogether because it may become financially infeasible to construct a profitable smaller project along with the inclusionary requirements.

Staff recommends that the Council consider establishing a minimum project size to apply the inclusionary housing requirement. The minimum size could be based on a project's proposed number of units or based on land area of the proposed lot. The most common threshold size in California cities is five to ten dwelling units. For projects with fewer than five to ten units, it may become economically infeasible to apply inclusionary requirements and discourage smaller developments and "missing middle" housing types. In addition, smaller projects tend to be developed by smaller local developers who are less familiar and operationalized to appropriately apply and report on affordability requirements over time.

As such, staff recommends the Council apply an exemption for smaller projects 10 units or less in order to continue encouraging smaller scale housing projects. Staff is seeking Council feedback whether to study a sliding scale in lieu fee for smaller projects rather than requiring onsite production.

Minimum "Set-Aside" and Affordability Level

The set-aside requirement should be set at a percentage amount that is supportable by the pending KMA financial evaluation. The financial evaluation will test different prototype projects (ownership and rental) to determine at which percentage and income level the requirement is feasible while providing a fair return on investment.

In California, most adopted inclusionary policies are based on a percentage and have fallen within the ten to 20-percent range - 15-percent being the most common. For example, if a new development project proposes 100 dwelling units and the requirement is 10-percent then 10 of the 100 units must be deed restricted as affordable to moderate or lower-income households. The preliminary findings of the KMA analysis for the base zoning scenario indicates a 10% set aside for low income units for a rental project and an 8% set aside for moderate income units for an ownership project is potentially supportable in Costa Mesa. However these findings may be modified and updated pending the completion of the final financial evaluation.

The set-aside requirement could apply to any income level. For example, a 10-percent requirement could be applied but the developer could choose which affordability level to provide, as long as they provide the minimum number of units. However, it is likely the moderate-income level would be pursued since the return on investment is more beneficial for developers at the higher income level. As another option, the set-aside requirement could be based on a combination of income levels, for example, a 10-percent requirement with 7-percent required to be at the very low and 3-percent at the low- or moderate-income level. This combination approach could produce more lower-income units compared to moderate-income units, more directly addressing the segments of the Costa Mesa community that experience the greatest housing instability. A combination approach is also more consistent with the City's 2021-2029 RHNA allocation.

The set-aside percentage requirement can be the same for rental and ownership housing but the affordability level should be considered differently for each housing type. Inclusionary policies typically require ownership housing projects to provide units at the moderate-income levels. Rental projects most often are required to provide units at the low, very-low income, and in some programs, extremely-low level. Extremely-low income units are not built as often due to the limited and often negative return on investment for developers. Extremely low-income units are typically built by affordable housing developers and are supported by public funding sources which subsidize housing for individuals and families that fall within this category.

Requiring the inclusionary units (especially for rentals) to be allocated across multiple income levels could provide deeper affordability. Other Orange County cities have included this approach in their programs. The City of Santa Ana's set-aside requirement is a tiered system with the highest percentage at 15-percent for low-income units and the percentage is lowered if deeper affordability is provided e.g., 10-percent for very low-income, 5-percent for extremely-low units, etc. The Council could consider a similar tiered set-aside and affordability level requirement (if supported by the financial evaluation).

Staff recommends that ownership housing affordability be focused on the moderate income level and rental housing affordability levels be focused on low income and very low income in cases where a density bonus is used.

Covenant Period

It is standard for inclusionary housing programs to require a specific length of time the units must remain affordable. Covenants for ownership units usually range from 30 to 45 years and those for rental housing are most often 55 years. Projects that utilize the State's density bonus are already subject to rental or ownership term restrictions but should the City require more stringent terms, the higher requirement would prevail. The State density bonus law requires 55 years for rental units which could explain why many programs adopt the same terms. For ownership, State density bonus law requires no minimum covenant period. When a unit is resold, it is sold at the market rate and the seller must pay to the City the difference in the market rate price compared to the affordable price at the time of original purchase and a proportionate share of the equity appreciation.

Staff recommends a 55-year covenant for rental units and is seeking Council feedback regarding applying the same re-sale procedures as provided by State density bonus law for ownership units or establish a set covenant period which will require long term re-sale oversight to ensure ownership units are sold at the affordable price and occupied by eligible household over the duration of the covenant period.

Alternative Compliance Options

While there should be a heavy emphasis and encouragement to provide inclusionary units onsite, it is required under State law that the City provide an alternative option to comply with the inclusionary housing requirement if a project cannot satisfy it with onsite units. Alternatives should only be available when onsite units are less feasible and under specific circumstances and not as a default option for developers to choose at their sole discretion.

As described in the above section of this Agenda Report, there are four main alternative compliance options. The City should consider including a menu of options to provide developers with reasonable flexibility, but also ensure production of as many or more affordable units as would have been required onsite in order to accomplish the goal of an inclusionary housing program.

In-Lieu Fees

In-lieu fees is a payment option if units cannot be provided onsite. In-lieu fees are established as either a fixed amount per unit or are applied on a square foot basis. Fees are updated from time to time to reflect current market conditions. In-lieu fees are collected by the City as a revenue source to support, fund and/or subsidize affordable housing within the City.

Payment of in-lieu fees is a typical option in many inclusionary housing programs and the fees collected are allocated to a housing fund to benefit housing related programs in the City. The fee amount should be set at an amount supportable by the pending KMA financial evaluation. The pending financial evaluation will analyze the appropriate in-lieu fee amount for both rental and ownership housing types. The fee amount should not be set too low such that it would not achieve the goals or benefits of the inclusionary housing program. It should also not be too high where it could result in an impact on feasible development and could deter housing. The fee amount may also need to change over time to reflect the changes in construction costs and other market forces. As such, staff recommends fees be adopted by Resolution so fees can be adjusted on a regular basis without the need to amend the ordinance.

KMA preliminary findings supports an in-lieu fee of approximately $25 per square foot of floor area for both rental and ownership projects under the base zoning (no density bonus) scenario. These fee estimates will be refined and expanded upon completion of the pending analyses.

In-lieu fees can be allowed to be paid by right for all projects or for certain project types (ownership or rental), sizes (smaller projects), or affordability levels in order to incentivize specific Council priorities. They can also be allowed to be paid only under a certain specific set of circumstances on order to incentivize onsite production. Staff is seeking Council feedback regarding the possibility of using a sliding scale of in lieu fees to incentivize certain housing types and characteristics.

Offsite Production

The affordable units may be constructed at another location within the same jurisdiction. Offsite units are required to meet the same affordability level and covenant period that would have applied to onsite units.

Allowing offsite production (within City boundaries) of inclusionary units is also another common alternative option. A developer may choose this option if it is not feasible to develop the units onsite but they have the ability to construct and provide them offsite elsewhere in the City on a property they own or have access and ability to develop. However, offsite units should still be produced nearby the original project to foster mixed income neighborhoods or at least dispersed equitably throughout the community and not clustered in one area. Offsite units should be constructed concurrently with the project that required the inclusionary units. Requiring the offsite units be built at the same time or before the original project would ensure the affordable units are actually provided and not just an option to avoid complying with the inclusionary requirements. Other inclusionary programs that have included offsite units as a compliance option tend to require more units to be built offsite than would have been required onsite. Offsite production usually involves cost savings, so the City should require more units to ensure an equal value. In doing so, it ensures onsite and offsite construction have similar costs.

Staff recommends Council include offsite production as an option subject to requirements generally described above, understanding it may only be applicable in limited cases due to the limited availability of developable land.

Land Dedication

Developers could be allowed to dedicate property in-lieu of constructing affordable units onsite or offsite. Dedicated land must be located within the jurisdiction’s boundaries.

The benefit of including land dedication or donation as another compliance option is the land could be used to develop other needed types of housing that an inclusionary housing ordinance may not typically produce such as permanent supportive housing or housing for special needs populations. Donated land should also be equivalent or greater in value than onsite units. Because cities do not typically develop and construct housing units, the City could consider partnering with a reputable affordable housing developer to construct and manage an affordable housing project on the donated land. In such case, the land dedication should be conveyed to the City who could then lease it to an affordable housing developer. The donated land should be suitable for a housing development so the inclusionary ordinance should include criteria for what is suitable land for dedication. For example, the size and physical characteristics should be reasonable to develop units at a certain density; if the dedicated land is too small, then it may not be economically viable.

Staff recommends Council include land dedication as an option subject to specific requirements generally described above, understanding it may only be applicable in limited cases due to the limited availability of developable sites without major constraints.

Acquisition and Substantial Rehabilitation

Developers could be allowed to acquire and rehabilitate existing offsite market rate rental units within the jurisdiction's boundaries and applying affordable covenants to those units. The same affordability level and covenant period that would apply to onsite units also apply to these rehabilitated units.

Though this option is not as common, some Orange County cities also include it in their inclusionary housing program. This option would allow a developer to rehabilitate an existing housing project in the City. Although rehabilitation may be a good policy, it is not as desirable as an inclusionary housing requirement alternative because it is not producing additional new affordable units and therefore the units cannot be counted toward the City's RHNA allocation. The other concern with this option is potential impacts to existing tenants while the property is undergoing renovations. The benefit of this option is potentially extending the life of existing housing and improving aging properties.

Staff is seeking feedback as to whether to include rehabilitation as an option.

Credits

Although not as common as other alternative compliance options, some cities (such as Irvine) allow developers who construct a greater number of inclusionary units than required to gain "credits". These credits may be used in future projects or can be transferred to another housing developer. Oftentimes, credits must be equivalent to the units in the originating project and have expiration dates from year of issuance.

Although uncommon in other inclusionary programs, the City could also consider a credit system for developers who construct affordable units beyond the minimum requirement. For example, if 10 units are required to be affordable and the developer constructs 15 units - five of the units could be "credited" towards the developer's future housing project in the City. Alternatively, the developer could transfer their credit to another housing developer that could be applied to their project in the City. The credits could be given for other reasons that could also be considered "above and beyond" the inclusionary requirements besides providing more affordable units than required. For example, credits could be given for providing deeper affordability than required such as extremely-low income level or providing affordable units with smaller (studios) or higher bedroom (3-bedrooms) count. As part of its next steps, staff could evaluate further whether credits could work well in Costa Mesa.

Concessions and Incentives

In addition to the minimum requirements included in most inclusionary housing programs, some cities offer incentives to developers to offset costs associated with providing affordable units to further incentivize housing development or in exchange for more affordable units or deeper affordability. These may include greater density than allowed in the underlying zone, flexible development standards, expedited processing, or financial subsidies including but not limited to a reduction/waiver of certain fees. As part of its next steps, staff could evaluate further whether these types of incentives could work well in Costa Mesa.

Unit Mix

Unit mix could also be considered in the inclusionary ordinance. For example, the City could require or incentivize the production of a certain number or percentage of housing units to be studios, one, two, or three-bedrooms. By requiring a certain unit mix, it could ensure housing units are available for a range of household sizes. The City could consider which unit mix would be the most beneficial given the community’s profile and incentivize specific unit types. For example, the City may want to incentivize the provision of studio units for seniors who live independently or two and three-bedroom units for large families or multi-generational households. As part of its next steps, staff could evaluate further whether requirements or incentives for these types of housing or housing characteristics could work well in Costa Mesa.

Program Implementation and Compliance

If an inclusionary ordinance is adopted, it would create a new housing program that would require additional resources to implement, manage, monitor, and enforce inclusionary requirements for the duration of the program. Such tasks would include but are not limited to the collection and management of in-lieu fees, preparation of requests for proposals, agreements, and staff reports for the allocation of in-lieu housing funds, development of community development partnerships, preparation and monitoring of affordable housing agreements for each inclusionary project, annual rent certifications to ensure required units are rented to households at the appropriate income levels, and appropriate tracking and reporting of units to the State annually.

The Council should also consider identifying and articulating in the inclusionary ordinance the potential uses of collected in-lieu fees. For example, in-lieu fees could be used as additional funding to leverage State and federal funds to fund an affordable housing project, to produce needed units that the inclusionary requirement is not producing such as extremely-low income units, funding to preserve existing affordable units with expiring covenant periods, subsidizing the production of ownership units in places where the inclusionary requirement is primarily creating for-rent units (or vice versa), and/or funds the development of affordable units in parts of the City where development is not occurring and thus the inclusionary requirement is having no impact. The Council should also consider using in-lieu fees to fund existing housing support programs that could benefit from the flexibility afforded by using a local funding source (as opposed to State or federal funds) and using in-lieu fees to ensure adequate City resources are allocated to manage the inclusionary housing program in the long-term.

Stakeholders Feedback

As part of staff's analysis and research regarding the potential impacts and opportunities of an inclusionary housing ordinance in Costa Mesa, staff met with both local affordable housing advocate groups and local housing developers with expertise in land development. In all, staff conducted six separate meetings. All stakeholders were generally accepting or supportive of an inclusionary housing program in Costa Mesa and understood the need for one; however, as with any local ordinance the detailed components and how they all come together will ultimately determine the overall effectiveness and feasibility of the program in Costa Mesa. Below is a summary of feedback from these initial meetings:

- **In-Lieu Fees:** The stakeholders were supportive of providing in-lieu fees as an alternative compliance option. It was discussed that the fee should be an appropriate amount because if too high, it could deter housing projects. It was also discussed that the in-lieu fee is more beneficial for and should be applied to smaller housing projects;

- **Land Costs:** Housing developers indicated that an inclusionary housing program will impact land value in that the cost of producing affordable units will be factored into the price a housing developer is willing to pay to acquire property for a project. This was a particular concern for commercially- or industrially-zoned properties where housing could be allowed through modified zoning, but if a developer's offer to purchase the property is lower than a land owner is willing to take (due to development costs), and if the land owner has a viable and profitable commercial or industrial property, a land owner could prefer to keep the property as is rather than sell the land for housing. Because the market changes often, the ability to modify the ordinance flexibly is also important;

- **Incentives:** Stakeholders concurred that the density bonus will be utilized more with an inclusionary housing requirement and understood that the City is required to grant concessions/incentives. The concessions under the density bonus provisions sought by developers most often included lower parking requirements, building height and setbacks. Some suggested including additional incentives such as expediting processing by identifying a staff team responsible only for housing entitlement projects in the City, streamlining processes by using by right development and objective design standards (as opposed to discretionary processes), offering flexibility in key provisions of the ordinance (for example, longer covenants) in exchange for a lower percentage, or fee waivers were also mentioned; and

- **Workforce Housing and First-time Home Buyers:** Housing advocates emphasized the need for workforce housing, which is housing for Costa Mesa residents at the low to moderate-income level, so that people can live where they work and in turn, improve their quality of life and be part of the community they work in. Focusing policy on the very low- and low-income categories is critical for rental units. In addition, it was discussed that the inclusionary program should incentivize affordable ownership units especially for first time home buyers and not just affordable rental units. It was mentioned that younger individuals and families are leaving Orange County due to unattainable housing prices. It was also suggested that the City should consider a more aggressive affordable housing requirement for the Fairview Developmental Center, since the land is State-owned.

Next Steps

Following the joint study session, KMA will complete its draft financial evaluation working with staff to incorporate additional and modified sensitivity analyses and scenarios and will prepare policy recommendations, incorporating community feedback and the direction received from the City Council and Planning Commission.

Staff in coordination with the City Attorney's Office would then prepare a draft Costa Mesa specific ordinance, followed by implementing guidelines. A draft ordinance framework is provided as Attachment 7 to provide the Council with the general understanding of the layout and components of the future ordinance. The Ordinance would be completed incorporating the entire comprehensive inclusionary program, upon Council direction.

The draft Costa Mesa specific ordinance based on the KMA financial evaluation could be presented to the Planning Commission this summer for review and recommendation to City Council. Following Planning Commission's recommendation, the first reading of the draft ordinance would be presented to City Council for consideration. If the first reading is approved, the second reading would be scheduled for the next meeting. If the second reading is approved, then the ordinance becomes effective 30 days thereafter.

Subsequent evaluation of fees and staff/consultant resources necessary to implement the new inclusionary housing program would be presented at a later date.

ALTERNATIVES:

The City Council could request an additional study session following the completion of the financial evaluation and draft policy recommendations. An additional study session could provide additional opportunities for feedback and direction, if necessary, prior to staff finalizing a draft ordinance.

FISCAL REVIEW:

There is no impact to the City's General Fund from a policy discussion pertaining to inclusionary housing. However, if the Council directs staff to move forward with preparation of a draft ordinance, staff will evaluate the fiscal impacts of such an ordinance, including the potential for revenue in the form of housing in-lieu fees and the potential for additional staff or consultant resources necessary to manage an affordable housing program over time.

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 inclusionary 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. Furthermore, the inclusionary 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 and Planning Commission regarding the various components of an inclusionary housing ordinance including project threshold size, target affordability levels, covenant periods, compliance options, and any other policy initiatives the Planning Commission or City Council would like to consider.

STATE OF CALIFORNIA - BUSINESS, CONSUMER SERVICES AND HOUSING AGENCY GAVIN NEWSOM, *Governor*

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
DIVISION OF HOUSING POLICY DEVELOPMENT
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May 9, 2023

Lori Ann Farrell Harrison, City Manager
City of Costa Mesa
77 Fair Drive
Costa Mesa, CA 92626

Dear Lori Ann Farrell Harrison:

RE: City of Costa Mesa's 6th Cycle (2021-2029) Adopted Housing Element

Thank you for submitting the City of Costa Mesa's (City) housing element that was adopted on November 15, 2022 and received for review on March 10, 2023. In addition, the California Department of Housing and Community Development (HCD) considered technical modifications from its prior review authorized by Resolution Number 2022-67. Pursuant to Government Code section 65585, subdivision (h), HCD is reporting the results of its review. In addition, HCD considered comments from Costa Mesa First pursuant to Government Code section 65588, subdivision (c).

The adopted housing element meets the statutory requirements of State Housing Element Law (Gov. Code, § 65580 et seq.). However, the housing element cannot be found in substantial compliance until the City has completed necessary rezones to make prior identified sites available and address the shortfall of sites to accommodate the RHNA pursuant to Assembly Bill 1398 (Chapter 358, Statutes of 2021) as described below.

Pursuant to Assembly Bill 1398 (Chapter 358, Statutes of 2021), a jurisdiction that failed to adopt a compliant housing element within one year from the statutory deadline cannot be found in compliance until rezones to make prior identified sites available or accommodate a shortfall of sites, pursuant to Government Code section 65583, subdivision (c) (1) (A) and Government Code section 65583.2, subdivision (c), are completed. As this year has passed and Programs 3B (Fairview Development Center), 3C (North Costa Mesa Specific Plan), 3D (Urban plans and Overlays), and 3N (Reused sites) have not been completed, the housing element is out of compliance and will remain out of compliance until the rezoning has been completed. Once the City completes the rezone, a copy of the resolution or ordinance should be transmitted to HCD. HCD will review the documentation and issue correspondence identifying the updated status of the City's housing element compliance.

Additionally, the City must continue timely and effective implementation of all programs including but not limited to the following:

- Program 2A (Inclusionary Housing Ordinance)
- Program 2B (Affordable Housing Development)
- Program 2I (State Density Bonus Incentives)
- Program 2J (Transitional and Supportive Housing)
- Program 2M (Parking Standards for Residential Development)
- Program 2N (Reasonable Accommodation)
- Program 2O (Definition of Single Housekeeping Unit)
- Program 2P (Group Homes): Please note, HCD may follow up with additional technical assistance. Please see HCD's Group Home Technical Advisory at https://www.hcd.ca.gov/sites/default/files/docs/planning-and-community/group-home-technical-advisory-2022.pdf.
- Program 3B (Fairview Development Center)
- Program 3G (City-wide Vote Requirements)
- Program 3R (Development of Large Sites)
- Program 4A (Fair Housing)

The City must monitor and report on the results of these and other programs through the annual progress report, required pursuant to Government Code section 65400. Please be aware, Government Code section 65585, subdivision (i), grants HCD authority to review any action or failure to act by a local government that it determines is inconsistent with an adopted housing element or State Housing Element Law. This includes failure to implement program actions included in the housing element. HCD may revoke housing element compliance if the local government's actions do not comply with state law.

Several federal, state, and regional funding programs consider housing element compliance as an eligibility or ranking criteria. For example, the CalTrans Senate Bill (SB) 1 Sustainable Communities grant, the Strategic Growth Council and HCD's Affordable Housing and Sustainable Communities programs, and HCD's Permanent Local Housing Allocation consider housing element compliance and/or annual reporting requirements pursuant to Government Code section 65400. With a compliant housing element, the City will meet housing element requirements for these and other funding sources.

For your information, some general plan element updates are triggered by housing element adoption. HCD reminds the City to consider timing provisions and welcomes the opportunity to provide assistance. For information, please see the Technical Advisories issued by the Governor's Office of Planning and Research at: https://www.opr.ca.gov/planning/general-plan/guidelines.html.

HCD appreciates the dedication and cooperation of the City's housing element team provided during the review and update. HCD particularly applauds the efforts of Jennifer Le and Scott Drapkin whose collaboration, communication, expertise and public service is truly commendable. HCD wishes the City success in implementing its housing element and looks forward to following its progress through the General Plan annual progress reports pursuant to Government Code section 65400. If you have any questions or need additional technical assistance, please contact Jose Armando Jauregui of our staff, at Jose.jauregui@hcd.ca.gov.

Sincerely,

Paul McDougall
Senior Program Manager

SUMMARY TABLE

HOUSEHOLD INCOMES & AFFORDABLE HOUSING COSTS
INCLUSIONARY HOUSING: FINANCIAL EVALUATION
COSTA MESA, CALIFORNIA

I. Household Incomes

Number of Persons in the Household	Moderate Income	Low Income	Very Low Income
1	$100,050	$75,900	$47,450
2	$114,300	$86,750	$54,200
3	$128,600	$97,600	$61,000
4	$142,900	$108,400	$67,750
5	$154,350	$117,100	$73,200
6	$165,750	$125,750	$78,600
7	$177,200	$134,450	$84,050
8	$188,650	$143,100	$89,450

II. Affordable Rents

	Studio Units	One-Bedroom Units	Two-Bedroom Units	Three-Bedroom Units
Moderate Income	$2,201	$2,515	$2,807	$3,101
Low Income	$1,576	$1,800	$2,003	$2,208
Very Low Income	$951	$1,085	$1,199	$1,315

III. Affordable Sales Prices

	Two-Bedroom Units	Three-Bedroom Units	Four-Bedroom Units
Moderate Income	$439,900	$465,800	$490,600
Low Income	$203,300	$210,300	$216,100

DENSITY BONUS CHART*

AFFORDABLE UNIT PERCENTAGE**	VERY LOW INCOME DENSITY BONUS	LOW INCOME DENSITY BONUS	MODERATE INCOME DENSITY BONUS***	LAND DONATION DENSITY BONUS	SENIOR****	FOSTER YOUTH/ DISABLED VETS/ HOMELESS	COLLEGE STUDENTS
5%	20%	-	-	-	20%	-	-
6%	22.5%	-	-	-	20%	-	-
7%	25%	-	-	-	20%	-	-
8%	27.5%	-	-	-	20%	-	-
9%	30%	-	-	-	20%	-	-
10%	32.5%	20%	5%	15%	20%	20%	-
11%	35%	21.5%	6%	16%	20%	20%	-
12%	38.75%	23%	7%	17%	20%	20%	-
13%	42.5%	24.5%	8%	18%	20%	20%	-
14%	46.25%	26%	9%	19%	20%	20%	-
15%	50%	27.5%	10%	20%	20%	20%	-
16%	50%	29%	11%	21%	20%	20%	-
17%	50%	30.5%	12%	22%	20%	20%	-
18%	50%	32%	13%	23%	20%	20%	-
19%	50%	33.5%	14%	24%	20%	20%	-
20%	50%	35%	15%	25%	20%	20%	35%
21%	50%	38.75%	16%	26%	20%	20%	35%
22%	50%	42.5%	17%	27%	20%	20%	35%
23%	50%	46.25%	18%	28%	20%	20%	35%
24%	50%	50%	19%	29%	20%	20%	35%
25%	50%	50%	20%	30%	20%	20%	35%
26%	50%	50%	21%	31%	20%	20%	35%
27%	50%	50%	22%	32%	20%	20%	35%
28%	50%	50%	23%	33%	20%	20%	35%
29%	50%	50%	24%	34%	20%	20%	35%
30%	50%	50%	25%	35%	20%	20%	35%
31%	50%	50%	26%	35%	20%	20%	35%
32%	50%	50%	27%	35%	20%	20%	35%
33%	50%	50%	28%	35%	20%	20%	35%
34%	50%	50%	29%	35%	20%	20%	35%
35%	50%	50%	30%	35%	20%	20%	35%
36%	50%	50%	31%	35%	20%	20%	35%
37%	50%	50%	32%	35%	20%	20%	35%
38%	50%	50%	33%	35%	20%	20%	35%
39%	50%	50%	34%	35%	20%	20%	35%
40%	50%	50%	35%	35%	20%	20%	35%
41%	50%	50%	38.75%	35%	20%	20%	35%
42%	50%	50%	42.5%	35%	20%	20%	35%
43%	50%	50%	46.25%	35%	20%	20%	35%
44%	50%	50%	50%	35%	20%	20%	35%
100%*****	80%	80%	80%	35%	20%	20%	35%

*All density bonus calculations resulting in fractions are rounded up to the next whole number.
**Affordable unit percentage is calculated excluding units added by a density bonus.
***Moderate income density bonus applies to for sale units, not to rental units.
****No affordable units are required for senior units.
***** Applies when 100% of the total units (other than manager's units) are restricted to very low, lower and moderate income (maximum 20% moderate).

Orange County Cities Inclusionary Housing Programs

Jurisdiction	Threshold Units	Covenant Term	Set Aside	Affordability	Alternatives
Brea	20 units	55 years rental 45 years owner	10%	Undefined rental 120% AMI owner	In lieu, offsite
Huntington Beach	3 units	55 years rental 45 years owner	10%	80% AMI rental 120% AMI owner	In lieu, offsite, preserve/rehab existing
Irvine	50 units	30 years rental 30 years owner	15%	50-120% AMI rental 50-120% AMI owner	In lieu, land dedicate, credits, conversion, extend affordability terms of existing
Laguna Woods	5 units	45 years rental 45 years owner	15%	7.5% very low + 7.5% low rental 10% very low + 5% moderate owner	In lieu, offsite, land dedicate
La Habra	10 units	55 years rental 45 years owner	15%	6% very low + 9% moderate rental 110% AMI owner	In lieu, offsite, acquisition/rehab existing
San Clemente	6 units	20 years rental 20 years owner	15%	7.5% very low + 7.5% low rental 7.5% very low + 7.5% low owner	In lieu, offsite, land dedicate
San Juan Capistrano	2 units	55 years rental 55 years owner	10%	Undefined for rental and owner	In lieu, offsite, land dedicate, preserve/rehab existing
Santa Ana	5 units	55 years rental 55 years owner	5-15% rental 5% owner	15% low or 10% very low or 5% extremely low; 5% low + 3% very low + 2% extremely low	In lieu, offsite, rehab existing

PROTOTYPE RESIDENTIAL DEVELOPMENTS
INCLUSIONARY HOUSING: FINANCIAL EVALUATION
MAY 2023

Apartment Development Scenarios: Five Acre Site			
Description	Density (Units /Acre)	Total Number of Units	Affordability Requirements
Base Case: Current Zoning			
Inclusionary Scenario	20	100	Based on Evaluation Results
State Density Bonus Scenario	30	150	15 Very Low Income Units
Rezoning Scenarios: Value Enhancement Tests Based on Rezoning Standards Proposed in the Housing Element			
Base Case	30	150	15 Very Low Income Units – the Stabilized Return on Investment is Used in the Scenarios Testing
Scenario 1	35	175	15 Very Low Income Units + Additional Low Income Units Supported by the Value Enhancement Analysis
Scenario 2	40	200	
Scenario 3	50	250	
Scenario 4	90	450	

Ownership Housing Development Scenarios Affordability Requirements Based on the Financial Evaluation Results			
	Site Size (Acres)	Density (Units/Acre)	Total Number of Units
Townhome Project	3.0	20	60
Live / Work Project	2.5	16	40
Condominium Project	2.0	25	50

KEYSER MARSTON ASSOCIATES

EXECUTIVE SUMMARY

DRAFT INCLUSIONARY HOUSING: FINANCIAL EVALUATION

Prepared for:

City of Costa Mesa

Prepared by:

Keyser Marston Associates, Inc.

May 12, 2023

I. EXECUTIVE SUMMARY

A. Background

Keyser Marston Associates, Inc. (KMA) was engaged by the City of Costa Mesa (City) to assist in creating an Inclusionary Housing program. By way of background, over the past 20+ years the KMA Los Angeles office has assisted 36 jurisdictions in the Inclusionary Housing program adoption and updating processes. KMA's analyses reflect a real world perspective based on the firm's core experience in real estate development economics, real estate transactions, and developer negotiations services.

KMA was engaged to prepare an Inclusionary Housing: Financial Evaluation (Financial Evaluation) to identify supportable Inclusionary Housing program requirements for apartment and ownership housing development. The KMA evaluation methodology has been continually evolving over the past 20 years. Each study is tailored to reflect the specific characteristics of the jurisdiction being evaluated.

B. Public Policy Objectives

The first step in designing an Inclusionary Housing program is to identify the factors that will be considered in defining the program's goals. The characteristics of the unmet need for affordable housing in the community are commonly assessed for this purpose. The KMA Financial Evaluation uses information presented in the City's Draft Housing Element (Housing Element) dated March 1, 2023. The Housing Element covers the period between 2021 and 2029.

Inclusionary Housing programs are subject to both statutory parameters imposed by the State Legislature and the rulings in the court cases that have challenged Inclusionary Housing programs over the past 30+ years. Significant statutes and court rulings are summarized below. It is important to understand the constraints and opportunities that are created by these statutes and court rulings.

SAN JOSE CASE

In the 2015 San Jose case, the California Supreme Court ruled that Inclusionary Housing Programs should be viewed as use restrictions that are a valid exercise of a jurisdiction's zoning powers. Specifically, the Court found that Inclusionary Housing requirements are a planning tool rather than an exaction. This is interpreted to mean that an in-lieu fee payment option that is included in an Inclusionary Housing Program, that includes an affordable housing production requirement, is not subject to the AB 1600 nexus requirements imposed by California Government Code §66000 et seq.

While Inclusionary Housing Programs are not subject to AB 1600 requirements, these programs must comply with the following criteria:

1. The requirements cannot be "Confiscatory"; and

2. The requirements cannot deprive a property owner of a fair and reasonable return on their investment.

The court did not provide criteria under which jurisdictions can determine whether proposed price controls are confiscatory and/or they deprive a property owner of a fair and reasonable return. As a result, each jurisdiction is left to create an evaluation methodology that balances the interests of property owners, developers and the jurisdiction's need for affordable housing. It is KMA's practice to take a conservative approach in establishing the requirements that comport with the court's ruling.

ASSEMBLY BILL 1505

Assembly Bill (AB) 1505 amended Section 65850 of the California Government Code and added Section 65850.01. This legislation provides jurisdictions with the ability to adopt programs that impose Inclusionary Housing requirements on apartment development projects.

Section 65850.01 does not place a cap on the percentage of units that can be subject to income and affordability restrictions. However, Section 65850.01 (a) gives HCD the authority to review the restrictions imposed by an Inclusionary Housing Program on apartment developments if it requires that more than 15% of the units to be restricted to households earning less than 80% of the area median income (AMI), and if one of the following conditions applies:

CALIFORNIA GOVERNMENT CODE SECTION 65583 (A)

California Government Code Section 65583 (a) (Section 65583 (a)) requires the City to analyze potential and actual constraints being placed on the development of housing. If the City chooses to impose a greater than 15% affordability requirement and/or a deeper affordability standard than 80% of AMI on apartment development, HCD can require the City to demonstrate that the Inclusionary Housing requirement does not create a constraint to housing development.

Section 65583 (a) requires the City to analyze potential and actual constraints being placed on the development of housing. Within that context, it is important to recognize that the requirements imposed by an Inclusionary Housing Program can only be expected to fulfill a small portion of the unmet need for affordable housing in Costa Mesa.

C. Financial Analyses

Each unit in a market rate project that is required to fulfill income and affordability restrictions creates an impact on the project economics. This is called the "Affordability Gap", which is defined as difference between the achievable market rate rent or sales price and the allowable rent or sales price for each "Inclusionary Unit". This Financial Evaluation uses pro forma analyses to estimate the Affordability Gaps generated at varying income and affordability levels.

KMA created prototype apartment and ownership housing developments for analysis purposes. The prototypes can be generally described as follows:

Development Prototypes Apartment Development and Ownership Housing Development	
Apartment Development	Ownership Housing Development
Base Zoning Standards	Townhomes
Section 65915 Density Bonus	Live / Work Units
	Condominiums

The prototype projects were created using the following resources:

1. The Housing Element; and

2. Residential projects identified in KMA's market surveys.

KMA used pro forma analyses to estimate the Affordability Gaps created by the Inclusionary Housing alternatives being tested. The results were then evaluated to identify requirements that balance the interests of the property owner, the developer, and the City's unmet need for affordable housing.

D. Findings

Supportable Inclusionary Housing Production Requirements

Apartment Development

Apartment development analyses have been prepared for Inclusionary Housing requirements set at the low income and very low income levels.

Rent Estimates

The rent estimates that were used as part of the Affordability Gap analyses are presented in the following table:

Projected Rents Apartment Development Prototypes			
Number of Bedrooms	Market Rate	Low Income	Very Low Income
0	$2,410	$1,576	$951
1	$2,970	$1,800	$1,085
2	$3,660	$2,003	$1,199
3	$4,400	$2,208	$1,315

Affordability Gap Estimates

The weighted average Affordability Gaps per Inclusionary Unit are estimated as follows for the apartment development prototypes:

Estimated Affordability Gaps Per Inclusionary Unit Apartment Development Prototypes	
Low Income Unit	$273,000
Very Low Income Unit	$414,000

Supportable Inclusionary Housing Requirements – Apartment Development

Based on the results of the pro forma analyses, KMA concluded that the following Inclusionary Housing requirements can be supported by apartment development projects:

Supportable Inclusionary Housing Requirement Base Zoning Prototype	
Low Income	10%
OR	
Very Low Income	7%

Based on all the factors considered in the apartment development evaluation, KMA has concluded that a 10% low income Inclusionary Housing obligation can be supported. Given the conservative approach taken by KMA, it is reasonable to conclude that a requirement of this magnitude is not confiscatory and that it will not deprive a property owner of a fair and reasonable return on their investment.

It is important to consider that some developers may wish to mitigate the financial impact created by the imposition of Inclusionary Housing requirements by using the density bonus provided under California Government Code Section 65915 et seq. (Section 65915). Moreover, in many cases it will be advantageous for a developer to provide very low income units to fulfill the Density Bonus requirements. The results of the KMA analysis indicate that the imposition of a 15% very low income requirement can be supported by projects that can provide the additional units on a cost effective basis.[1]

Ownership Housing Development

Inclusionary Housing programs generally set the affordability requirements for ownership housing development at the moderate income level. This is done as a reflection of the fact that higher income households are likely to have more discretionary income to devote to the ongoing costs associated with home ownership than that of lower income households. For reference purposes KMA also prepared analyses based on a low income requirement.

Sales Price Estimates

The sales price estimates that were used as part of the Affordability Gap analyses are presented in the following tables:

Projected Market Rate Sales Prices Ownership Housing Development Prototypes			
Number of Bedrooms	Townhomes	Live / Work Units	Condominiums
2	$846,000	$959,000	$806,000
3	$1,148,000	$1,208,000	$1,027,000

[1] The affordable housing requirements for Section 65915 density bonus projects are calculated as a percentage of the units allowed by a site's base zoning standards.

Affordable Sales Prices Ownership Housing Development Prototypes		
Number of Bedrooms	Moderate Income	Low Income
2	$439,900	$203,300
3	$465,800	$210,400

Affordability Gap Estimates

The weighted average Affordability Gaps per Inclusionary Unit are estimated as follows for the ownership housing development prototypes:

Estimated Affordability Gap Per Inclusionary Unit Ownership Housing Development Prototypes		
	Moderate Income	Low Income
Townhomes	$571,800	$819,700
Live / Work Units	$630,700	$876,700
Condominiums	$483,200	$731,100

Supportable Inclusionary Housing Requirements – Ownership Housing Development

Based on the results of the pro forma analyses, KMA concluded that the following Inclusionary Housing requirements can be supported by ownership housing development projects:

Supportable Inclusionary Housing Requirement Ownership Housing Development Projects		
	Moderate Income	Low Income
Townhomes	8%	5%
Live / Work Units	7%	5%
Condominiums	8%	6%

Given the magnitude of the Affordability Gaps associated with the provision of low income ownership housing units it is KMA's opinion that the Inclusionary Housing requirement should be set at the moderate income level. This will maximize the number of affordable ownership housing units that are produced, while minimizing the Affordability Gaps between the market rate sales prices and the "Affordable Sales Prices".

Supportable In-Lieu Fees

KMA converted the Affordability Gaps associated with the supportable Inclusionary Housing obligations into the in-lieu fee payments that would be required to fulfill the affordable housing requirements on site within a proposed residential development. The resulting in lieu fee amounts are presented in the following table:

Supportable In-Lieu Fee Payment Amounts Per Square Foot of Leasable of Saleable Area in a 100% Market Rate Project	
Apartments	$27.60
Ownership Housing	
Townhomes	$27.40
Live / Work Units	$25.60
Condominiums	$25.10

Due to the fact that the in-lieu fee payment is an optional method of fulfilling the Inclusionary Housing obligation, the amount of the fee does not have to track with the Affordability Gaps associated with providing Inclusionary Units. The City may wish to consider applying a premium to the in-lieu fee payment amount to discourage its use, or they may wish to apply a discount to the in-lieu fee when the policy objective is to obtain funding sources for use in assisting dedicated affordable housing projects.

E. Next Steps

The Financial Evaluation is meant to assist the City in creating an Inclusionary Housing program that is not confiscatory and that does not deprive property owners of a fair and reasonable return on their investment. This analysis is focused on the Inclusionary Housing requirements that can be imposed given the City's current zoning standards.

As the next step in the process, KMA will be preparing additional financial analyses based on the rezoning activities proposed in the Housing Element. It is a fundamental assumption that increasing the allowable density will enhance the value of development sites. Recognizing this, it is KMA's recommendation that affordable housing requirements be imposed as part of the rezoning activities. To provide context for the affordable housing requirements that can reasonably be imposed, KMA will prepare value enhancement analyses of prototype apartment developments under the following proposed density standards:

Value Enhancement Tests Based on Rezoning Standards Proposed in the Housing Element Five Acre Site		
	Density (Units / Acre)	Total Number of Units
Scenario 1	35	175
Scenario 2	40	200
Scenario 3	50	250
Scenario 4	90	400

After receiving input from the City Council, KMA will prepare the additional scenarios, and finalize the Financial Evaluation. This will include KMA recommendations for specific requirements to be imposed if the City chooses to move forward with an Inclusionary Housing Ordinance.

SUMMARY TABLE #1

APARTMENT DEVELOPMENT SUMMARY
INCLUSIONARY HOUSING: FINANCIAL EVALUATION
COSTA MESA, CALIFORNIA

			Base Zoning Prototype: 20 Units / Acre Density	§65915 Density Bonus Prototype: 30 Units / Acre Density
I.	**Project Description**			
	A. Site Area (Sf)		217,800	217,800
	B. Density (Units/Acre)		20	30
	C. Unit Mix			
	Studio Units		10	15
	One-Bedroom Units		30	45
	Two-Bedroom Units		50	75
	Three-Bedroom Units		10	15
	Total Units		100	150
	D. Total Leasable Area			
	Square Feet		98,850	148,275
	Per Unit		989	989
	E. Parking Spaces Per Unit		2.0	0.8
II.	**Development Costs**			
	Total	[1]	$57,019,000	$68,586,000
	Per Unit		$570,000	$457,000
	Per Square Foot of Leasable Area		$577	$463
III.	**Market Rate Rents Per Unit**			
	One-Bedroom Units		$2,970	$2,970
	Two-Bedroom Units		$3,660	$3,660
	Three-Bedroom Units		$4,400	$4,400
IV.	**Stabilized Net Operating Income**			
	Market Rate Alternative		$2,862,000	
	Low Income Alternative		$2,724,000	
	Very Low Income Alternative		$2,720,000	
	Density Bonus Alternative			$3,980,000
V.	**Property Acquisition Cost Reduction**			
	Low Income Alternative		13%	
	Very Low Income Alternative		13%	0.0%
VI.	**Market Rent Increase to Offset Impact**		4.8% - 5.7%	0.0%
VII.	**Supportable Inclusionary Housing Requirement**			
	Low Income Alternative		10%	
	Very Low Income Alternative		7%	
	Density Bonus Alternative			15% VL
VIII.	**In-Lieu Fee Per Square Foot of Leasable Area**	[2]	$27.60	

1 The development cost estimates are based on the pro forma analyses for the Market Rate Alternative in each scenario.
2 Based on a 10% Low Income Standard.

SUMMARY TABLE #2

OWNERSHIP HOUSING DEVELOPMENT SUMMARY
INCLUSIONARY HOUSING: FINANCIAL EVALUATION
COSTA MESA, CALIFORNIA

			Townhome Prototype	Live/Work Prototype	Condominium Prototype
I.	**Project Description**				
	A. Site Area (Sf)		130,680	108,900	87,120
	B. Density (Units/Acre)		20	16	25
	C. Unit Mix				
	Two-Bedroom Units		24	20	20
	Three-Bedroom Units		36	20	30
	Total Units		60	40	50
	D. Total Saleable Area				
	Square Feet		104,400	74,000	77,000
	Per Unit		1,740	1,850	1,540
	E. Parking Spaces Per Unit		2.0	2.0	2.0
II.	**Development Costs**				
	Total	1	$52,152,000	$36,871,000	$42,070,000
	Per Unit		$869,000	$922,000	$841,000
	Per Sf of Total Saleable Area		$500	$498	$546
III.	**Market Rate Sales Price Per Unit**				
	Two-Bedroom Units		$846,000	$959,000	$806,000
	Three-Bedroom Units		$1,148,000	$1,208,000	$1,027,000
IV.	**Net Revenue**				
	Market Rate Alternative		$58,242,000	$40,956,000	$44,348,000
	Moderate Income Alternative		$55,541,000	$39,274,000	$42,597,000
	Low Income Alternative		$55,863,000	$39,298,000	$42,438,000
V.	**Property Acquisition Cost Reduction**				
	Moderate Income Alternative		15.0%	13.0%	15.0%
	Low Income Alternative		13.0%	13.0%	16.0%
VI.	**Market Price Increase to Offset Impact**		3.7% - 4.3%	3.7% - 3.8%	3.9% - 3.6%
VII.	**Supportable Inclusionary Housing Percentage**				
	Moderate Income Alternative		8%	7%	8%
	Low Income Alternative		5%	5%	6%
VIII.	**In-Lieu Fee Per Sf of Total Saleable Area**		$27.40	$25.60	$25.10

[1] The development cost estimates are based on the pro forma analyses for the MARKET RATE ALTERNATIVE in each scer

PRELIMINARY DRAFT FOR DISCUSSION PURPOSES ONLY

ORDINANCE NO. 2023-XX

AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF COSTA MESA AMENDING THE COSTA MESA MUNICIPAL CODE, TITLE 13 (PLANNING, ZONING AND DEVELOPMENT) TO ESTABLISH AN INCLUSIONARY HOUSING PROGRAM

THE CITY COUNCIL OF THE CITY OF COSTA MESA DOES HEREBY ORDAIN AS FOLLOWS:

WHEREAS, in fall 2020, the City began preparation of its Housing Element and held multiple community outreach meetings to obtain feedback regarding community housing goals and priorities;

WHEREAS, the City submitted the Housing Element to the State for certification and adopted the Housing Element on February 1, 2022;

WHEREAS, following revisions that were required in order to respond to State comments and requests, the City Council re-adopted the 2021-2029 6th Cycle Housing Element on November 15, 2022;

WHEREAS, the Housing Element includes the City's housing goals, policies, and implementation actions (referred to as Housing Element "programs"). One of the Housing Element goals (Housing Goal #2) is to "facilitate the creation and availability of housing for residents at all income levels and for those with special housing needs";

WHEREAS, in order to accomplish this goal, the Housing Element identifies several housing programs including Program 2A which calls for the City to consider adoption of an inclusionary housing ordinance;

WHEREAS, the City retained an expert consultant, Keyser Marston Associates Inc. (KMA), to evaluate and make policy recommendations for a potential inclusionary housing ordinance, including the affordability percentage requirement and the potential for an in-lieu fee option;

WHEREAS, in May 2023, staff held several stakeholder meetings with housing advocates, housing developers, and the Building Industry Association (BIA) to gather feedback on a potential inclusionary housing ordinance;

WHEREAS, on May 16, 2023, City Council held a joint study session meeting including the City's the Planning Commission to discuss the components of an inclusionary housing ordinance and provided policy direction for staff to include in a draft inclusionary housing ordinance;

WHEREAS, the Planning Commission held a public hearing on DATE with all persons having the opportunity to speak for and against the proposed inclusionary housing ordinance and recommended VOTE;

WHEREAS, the City Council held a public hearing on DATE with all persons having the opportunity to speak for and against the proposed inclusionary housing ordinance;

WHEREAS, Ordinance No. 2023-XX has been reviewed for compliance with the California Environmental Quality Act (CEQA);

WHEREAS, the CEQA findings reflect the City's independent judgment and analysis;

WHEREAS, the City Council finds that the provisions of this Ordinance are consistent with the City of Costa Mesa's General Plan; and

WHEREAS, all legal prerequisites prior to the adoption of this Ordinance have occurred.

NOW, THEREFORE, THE CITY COUNCIL OF THE CITY OF COSTA MESA DOES HEREBY ORDAIN AS FOLLOWS:

SECTION 1. Compliance with CEQA.

SECTION 2. Inconsistencies. Any provision of this ordinance which is inconsistent with state law shall be interpreted in a manner to be consistent with state law. Any provision of the Costa Mesa Municipal Code or appendices thereto inconsistent with the provisions of this Ordinance, to the extent of such inconsistencies and no further, is hereby repealed or modified to that extent necessary to affect the provisions of this Ordinance.

SECTION 3. Severability. If any section, subsection, sentence, clause, phrase or portion of this Ordinance is for any reason held to be invalid or unconstitutional by the decision of any court of competent jurisdiction, such decision shall not affect the validity of the remaining portions of this Ordinance. The City Council of the City of Costa Mesa hereby declares that it would have adopted this Ordinance and each section, subsection, sentence, clause, phrase, or portion thereof, irrespective of the fact that any one or more sections, subsections, sentences, clauses, phrases or portions be declared invalid or unconstitutional.

SECTION 4. Effective Date. This Ordinance shall take effect and be in full force thirty (XX) days from and after the passage thereof, and prior to the expiration of fifteen (15) days from its passage shall be published once in the ORANGE COAST DAILY PILOT, a newspaper of general circulation, printed and published in the City of Costa Mesa or, in the alternative, the City Clerk may cause to be published a summary of this Ordinance and a certified copy of the text of this Ordinance shall be posted in the office of the City Clerk five (5) days prior to the date of adoption of this Ordinance, and within fifteen (15) days after adoption, the City Clerk shall cause to be published the aforementioned summary and shall post in the office of the City Clerk a certified copy of this Ordinance together with the names and member of the City Council voting for and against the same.

SECTION 5. Certification. The Mayor shall sign and the City Clerk shall certify to the passage and adoption of this Ordinance and shall cause the same to be published or posted in the manner required by law.

PASSED AND ADOPTED this _____ day of ________, 2023 by the following XX vote:

____
John Stephens, Mayor

ATTEST:

Brenda Green, City Clerk

APPROVED AS TO FORM:

Kimberly Hall Barlow, City Attorney

STATE OF CALIFORNIA)
COUNTY OF ORANGE) ss
CITY OF COSTA MESA)

I, Brenda Green, City Clerk of the City of Costa Mesa, do hereby certify that the above and foregoing is a true and correct copy of Ordinance No.2023-XX ____ introduced at a regular meeting of the City Council of the City of Costa Mesa held on the ____ day of _____, 2023, and was thereafter adopted at a regular meeting held on the _____ day of _______, 2023, by the following vote:

AYES: COUNCIL MEMBERS:
NOES: COUNCIL MEMBERS:
ABSTAIN: COUNCIL MEMBERS:
ABSENT: COUNCIL MEMBERS:

Said ordinance has been published or posted pursuant to law.

Witness my hand and the official seal of the City of Costa Mesa this ____ day of _______, 2023.

____
Brenda Green, City Clerk

(SEAL)

Purpose.

The purpose is to facilitate the development and availability of housing affordable to a broad range of households with varying income levels within the City to meet current and future affordable housing needs. Provision of inclusionary units within new residential developments will assure that new affordable housing units are distributed throughout the City in order to provide for economically diverse neighborhoods and sufficient housing opportunities affordable to all segments of the Costa Mesa community. It is intended in part to implement state policy that declares that local governments have a responsibility to exercise their powers to facilitate the development of housing to adequately provide for the housing needs of all economic segments of the community, as stated in Government Code Section 65580. It is also intended to implement Program 2A of the Housing Element of the General Plan which identifies an inclusionary housing program as a desirable housing policy that would require either production of affordable housing; payment of in-lieu fees, or alternative means of compliance to support construction of affordable housing units.

Definitions.

1. Area Median Income
2. Extremely-Low Income
3. Very-Low Income
4. Low-Income
5. Moderate-Income
6. Market Rate Housing Unit
7. Affordable Ownership Housing Unit
8. Affordable Rental Housing Unit
9. Inclusionary Housing Agreement
10. Affordable Housing Agreement
11. New Residential Project
12. Ownership Units

Applicability.

This ordinance shall apply to new ownership residential projects of XX or more units in size and to new rental residential projects of XX or more units in size.

Affordable Ownership Housing Units – Onsite Production.

The following requirements and standards shall apply to onsite production of affordable ownership housing units:

1. *Set-aside Requirement.* New ownership residential projects shall provide a minimum of XX% of the project's base units as affordable ownership housing units.

2. *Affordability Level.* The affordable ownership housing units shall be provided at the XX income level.

3. *Affordability Terms.* The affordable ownership units shall remain affordable for a period of XX years or as stated in the Affordable Housing Agreement, or other adopted agreement(s).

4. *Concurrent Construction.* The affordable ownership units shall be built concurrently with the market rate units as provided in the project's approved Construction Phasing Plan. All exterior and interior improvements, finishes, applicable packages, access to community amenities, etc. for the affordable unit shall be comparable, if not same, to the market rate units.

5. *Bedroom Mix.* The bedroom mix for the affordable ownership unit shall be proportional to the bedroom mix of the market rate units. The affordable units may be no more than XX% smaller in square footage than the average square footage of the market rate units.

6. *Location.* The affordable ownership units shall be dispersed and evenly distributed throughout the project.

Affordable Ownership Housing Units – Alternatives to Onsite Production.

Pursuant to Government Code Section XX, alternative methods of compliance must be provided for new residential projects that cannot produce the affordable units onsite. The following are the alternative options to fulfill the inclusionary housing requirement if onsite production of affordable ownership housing units is determined to be economically infeasible and would impose an extreme hardship:

1. *In-Lieu Fee.* A fee may be paid in lieu of providing the affordable ownership housing units.
    a. The fee shall be calculated based on $XX per the project's base unit/$XX per square foot/a formula as adopted by the City Council;
    b. The fee shall be paid prior to the issuance of the first building permit for any residential structure in the development project or as determined by the project's conditions of approval or other adopted agreement(s); and
    c. Fees paid to fulfill the inclusionary housing requirements shall be placed in the City's housing fund, the use of which is governed by this ordinance in the below section.

2. *Offsite Production.* Affordable ownership housing units may be provided offsite at one or several sites within the City of Costa Mesa and shall be located within a reasonable distance from the original project triggering the inclusionary housing requirement. The same provisions as outlined in subsection 1 through 6 for onsite of affordable ownership housing units shall also apply to the offsite affordable units.

3. *Land Dedication.* The City Council has the discretion to allow a developer to dedicate property in lieu of onsite production of affordable ownership units. The following requirements are applicable to any property proposed to be dedicated:
    a. The property shall be located in the City of Costa Mesa;
    b. The developer shall convey the property to the City at no cost;
    c. The site's General Plan and zoning standards shall allow for residential use at a density sufficient to allow for the project's required number of inclusionary affordable units to be developed; and
    d. The site shall be suitable in terms of size, configuration, and physical characteristics to allow for the project's required number of inclusionary affordable units to be developed.

4. *Acquisition and Rehabilitation of Existing Units.* The City Council has the discretion to allow a developer to acquire, rehabilitate and place affordability covenants on existing offsite units that are within the City of Costa Mesa. The offsite location of existing units shall meet the following requirements:
    a. The location shall be identified as at-risk in the City's Housing Element;
    b. At least XX% of the original project's base units shall be affordable for the same affordability level and period required in subsections 2 and 3; and
    c. Existing units shall be rehabilitated concurrently with the construction of the project's market rate units or as determined in the project's conditions of approval or adopted agreement(s).

Affordable Rental Housing Units – Onsite Production.

The following requirements and standards shall apply to onsite production of affordable ownership housing units:

1. *Set-aside Requirement.* New rental residential projects shall provide a minimum of XX% of the project's base units as affordable rental housing units.

2. *Affordability Level.* The affordable rental housing units shall be provided at the XX income level or a mix of XX and XX income levels.

3. *Affordability Terms.* The affordable rental units shall remain affordable for a period of XX years or as stated in the Inclusionary Housing Agreement, Affordable Housing Agreement, or other adopted agreement(s).

4. *Concurrent Construction.* The affordable rental units shall be built concurrently with the market rate units as provided in the project's approved Construction Phasing Plan. All exterior and interior improvements, finishes, applicable packages, access to community amenities, etc. for the affordable unit shall be comparable, if not same, to the market rate units.

5. *Bedroom Mix.* The bedroom mix for the affordable ownership unit shall be proportional to the bedroom mix of the market rate units. The affordable units may be no more than

XX% smaller in square footage than the average square footage of the market rate units. At least XX% of the units shall include a mix of XX-bedroom and XX-bedroom units.

6. *Location.* The affordable rental units shall be dispersed and evenly distributed throughout the project.

Affordable Rental Housing Units – Alternatives to Onsite Production.

The following are the alternative options to fulfill the inclusionary housing requirement if onsite production of affordable rental housing units is determined to be economically infeasible and would impose an extreme hardship:

1. *In-Lieu Fee.* A fee may be paid in lieu of providing the affordable ownership housing units.
    a. The fee shall be calculated based on $XX per the project's base unit/$XX per square foot/a formula as adopted by the City Council;
    b. The fee shall be paid prior to the issuance of the first building permit for any residential structure in the development project or as determined by the project's conditions of approval or other adopted agreement(s); and
    c. Fees paid to fulfill the inclusionary housing requirements shall be placed in the City's housing fund, the use of which is governed by this ordinance in the below section.

2. *Offsite Production.* Affordable rental housing units may be provided offsite at one or several sites within the City of Costa Mesa and shall be located within a reasonable distance from the original project triggering the inclusionary housing requirement. The same provisions as outlined in subsection 1 through 6 for onsite of affordable rental housing units shall also apply to the offsite affordable units.

3. *Land Dedication.* The City Council has the discretion to allow a developer to dedicate property in lieu of onsite production of affordable rental units. The following requirements are applicable to any property proposed to be dedicated:
    a. The property shall be located in the City of Costa Mesa;
    b. The developer shall convey the property to the City at no cost;
    c. The site's General Plan and zoning standards shall allow for residential use at a density sufficient to allow for the project's required number of inclusionary affordable units to be developed; and
    d. The site shall be suitable in terms of size, configuration, and physical characteristics to allow for the project's required number of inclusionary affordable units to be developed.

4. *Acquisition and Rehabilitation of Existing Units.* The City Council has the discretion to allow a developer to acquire, rehabilitate and place affordability covenants on existing

offsite units that are within the City of Costa Mesa. The offsite location of existing units shall meet the following requirements:

a. The location shall be identified as at-risk in the City's Housing Element;
b. At least XX% of the original project's base units shall be affordable for the same affordability level and period required in subsections 2 and 3; and
c. Existing units shall be rehabilitated concurrently with the construction of the project's market rate units or as determined in the project's conditions of approval or adopted agreement(s).

Density Bonus and Incentives.

If the developer is proposing to provide affordable ownership or rental units in exchange for an increase in density, concessions, incentives, or waivers/modifications of development standards pursuant to the State Density Bonus Law (Government Code Section 65915), those affordable units may count as inclusionary units provided they meet the requirements outlined in this ordinance.

Notwithstanding the required concessions and incentives pursuant the State Density Bonus Law, the City Council or their designee in its sole discretion may grant additional incentives to encourage the construction of inclusionary units.

Agreements.

Applications for new residential development projects shall be approved only concurrently with the approval of an Inclusionary Housing Agreement. This agreement shall not apply if the developer chooses to pay a fee in-lieu of providing inclusionary units.

Use of In-Lieu Fees.

In-lieu fees collected as part of the inclusionary housing program shall be placed in a housing fund to be used for furthering existing housing support programs for the community including but not limited to subsidy for 100% affordable housing projects, loans for a first-time home buyer program, rental assistance program. In addition, the fees may be used to implement and manage the inclusionary housing program.

In-Lieu Fee Adjustments.

The in-lieu fee amount shall be adjusted annually/bi-annually/as determined by the City Council or their designee. The fee adjustment shall be adopted by resolution.

Exemptions.

This ordinance shall not apply to accessory dwelling units.