77 Fair Drive
Costa Mesa, CA 92626

ATTACHMENT 2

Item #: 24-102 **Meeting Date: 4/2/2024**

TITLE: SECOND READING OF ORDINANCE NO. 2024-02 AMENDING TITLE 13 (PLANNING, ZONING AND DEVELOPMENT) OF THE COSTA MESA MUNICIPAL CODE TO ESTABLISH AFFORDABLE HOUSING REQUIREMENTS FOR NEW RESIDENTIAL DEVELOPMENT PROJECTS AND FEE RESOLUTION TO ESTABLISH THE AFFORDABLE HOUSING IN-LIEU FEE SCHEDULE

DEPARTMENT: ECONOMIC AND DEVELOPMENT SERVICES DEPARTMENT/PLANNING DIVISION

PRESENTED BY: NANCY HUYNH, PRINCIPAL PLANNER

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

RECOMMENDATION:

Staff recommends the Council:

1. Find that the project is categorically exempt from the California Environmental Quality Act (CEQA), Section 15061(b)(3) (“General Rule”).

2. Give second reading to and adopt Ordinance No. 2024-02 approving the Affordable Housing Ordinance and amending Title 13 to establish the affordable housing requirements for new residential development projects.

3. Adopt a fee resolution establishing the affordable housing in-lieu fee schedule.

BACKGROUND:

Based on recent housing data analyzed in the adopted 2021-2029 Housing Element, it has been shown that half of renters in Costa Mesa experience housing cost burdens. Because these lower income households are “priced out”, they tend to move into more crowded living conditions to reduce their housing expenses, move further away for cheaper housing at the expense of longer commute times, move out of the state, or unfortunately, enter into homelessness. An affordable, or inclusionary, housing policy is a key tool that cities throughout the United States have adopted to address housing affordability in their communities. To address this affordable housing issue, Housing Program 2A (Inclusionary Housing Ordinance) of the Housing Element was included to “analyze the market impacts and potential affordability requirements for an inclusionary housing requirement for specific projects” in the City.

2021-2029 Housing Element

While the State Department of Housing and Community Development (HCD) approved the City's adopted Housing Element, it has not been deemed in substantial compliance with State housing law until specific housing programs have been implemented. The 40 housing programs included in the Housing Element are intended to increase housing production while also addressing housing affordability for all income levels. These housing programs would remove barriers to housing developments and reform current zoning regulations that may currently encumber housing production in the City.

Implementation of Program 2A (adoption of an inclusionary housing ordinance) is required for the City to maintain compliance with State housing laws. If the City does not implement Program 2A, the State could find the City's Housing Element out of compliance and in violation of State housing laws. This could leave the City vulnerable to legal challenges from the State and potentially result in significant legal fees to defend against any litigation. In addition, the HCD has the ability to penalize the City with fines up to $100,000 per month if the City's Housing Element is determined to be in violation of State housing law. The City could also lose local control over land use and permitting decisions including the authority to issue building permits for any type of projects or improvements. Such has been the case in the City of Beverly Hills and more locally, San Clemente. Lastly, without a certified Housing Element, the City risks continued ineligibility for receipt of State and County funding sources or loan programs that could support housing programs including gap funding assistance for 100% affordable housing projects such as Jamboree Housing's proposed Senior Center housing project.

Regional Housing Needs Assessment (RHNA)

California's RHNA is the basis for determining the State's future housing need by income category and is based on growth in population, households, and employment. For the 2021-2029 6th Housing Element, the City was allocated 11,760 housing units to accommodate the City's projected housing needs, with more than half of those housing units required to be affordable. The City's RHNA allocation is divided amongst four income categories, which are benchmarked on the County of Orange's median income for a family of four. Table 1 below identifies the four income categories by which the City's RHNA allocation is divided.

Table 1 – City of Costa Mesa RHNA by Income Category

Income Category	Percent of Median Family Income (MFI)	Costa Mesa's RHNA Allocation for the 2021-2029 Planning Period
Very Low Income	0-50% MFI	2,919 units
Low Income	51-80% MFI	1,794 units
Moderate Income	81-120% MFI	2,088 units
Above Moderate Income	>120% MFI	4,959 units
	Total	11,760 units

Adoption of an Affordable Housing Ordinance (AHO) would assist in achieving the City's RHNA for the very-low-, low-, and moderate-income categories, coupled with the other Housing Element programs intended to remove or reduce existing barriers and constraints to market-rate housing developments.

An "Incentive-Based" Program

The City's proposed Affordable Housing Program has been structured as an "incentive-based program".

To implement the Affordable Housing Program, the City would rezone non-residentially zoned properties located along major corridors to allow for higher density housing with reduced parking requirements and the allowance of affordable rents for low income units to be calculated based on 80% of the area median income (AMI) where 60% is required under state density bonus law. Adding residential development as an allowed use at higher densities creates land value and incentivizes housing production overall. That value is coupled with a requirement to provide a portion of the project's units as affordable housing. This program structure is in effect a local density bonus program.

The rezone and increase in density create opportunities for new homes that presently do not exist because of the lack of available properties that allow residential uses and the historically low maximum allowable density in Costa Mesa (maximum of 20 units per acre pursuant to the City's General Plan). Rezoning would create value and thus, incentivizing landowners to sell commercial and industrial properties to housing developers and incentivize housing developers to build.

DISCUSSION

City Council First Reading

On January 16, 2024, the City Council considered the Planning Commission's recommendations, discussed the draft ordinance, and made further changes to the draft including:

- Establishing a minimum threshold project size for application of the affordability requirements;
- Requiring the onsite production of affordable units for rental projects with over 50 units;
- Allowing payment of in-lieu affordable housing fees for rental projects with fewer than 50 units;
- Allowing payment of in-lieu affordable housing fees for ownership projects; and
- Allowing a residential project for which the City enters into a development agreement to provide affordable housing or other community benefits equivalent to the Affordable Housing Ordinance requirements.

The City Council voted 4-2 (Councilmember Chavez and Mayor Pro Tem Harlan voting no; Councilmember Harper absent) to give first reading of Ordinance No. 2024-02. The January 16, 2024 City Council agenda report, meeting video, and public comments are included in the links below:

- January 16, 2024 City Council Agenda Report: https://costamesa.legistar.com/View.ashx?M=F&ID=12583737&GUID=46F95F9D-81D5-4D12-9292-3369710C4230

- January 16, 2024 City Council Meeting Video: https://costamesa.granicus.com/player/clip/4078?view_id=14&redirect=true

- January 16, 2024 City Council Public Comments: https://costamesa.legistar.com/View.ashx?M=E3&ID=1144863&GUID=584645D0-2AD4-4EB6-

9E72-78009403D0D6

The City Council's modifications to the draft ordinance are included as Attachment 3. Their changes are shown as underlined and ~~strikethrough~~. Table 2 below provides a summary of the Affordable Housing Program components and requirements included in the City Council's first reading.

Table 2 – Proposed Affordable Housing Program Components and Requirements

Program Component	Proposed Requirements
Project Threshold	15 units
Number of Affordable Units/Required Income – Rental Project	• 60+ dwelling unit (du)/acre: 11% at low-income or 7% at very-low income • Under 60 du/acre: 6% at low-income or 4% at very-low income
Number of Affordable Units/Required Income – Ownership Project	Payment of in-lieu fee
Covenant Period – Rental	At least 55 years
Covenant Period – Ownership	45 years (if producing affordable units onsite)
Affordable Unit Minimum Size	No more than 15% smaller than average market rate unit
Affordable Unit Bedroom Mix	Proportional to market rate units
Affordable Unit Location	Evenly distributed/dispersed throughout residential project
Alternatives for Compliance	• Land dedication • Offsite construction of affordable units • Payment of in-lieu fees: ○ *Ownership:* All ownership projects can pay in-lieu fee ○ *Rental:* Rental projects fewer than 50 units can pay in-lieu fee • Onsite construction of rental units (ownership only)
Incentives	• Allow residential uses in commercial/industrial corridors • Increased densities • Allow low-income rents to be charged based on 80% AMI vs. 60% AMI (required by State density bonus) • Reduced parking requirements • Concurrent processing

City Council Study Session on Proposed In-Lieu Fee Amounts

As part of their first reading discussion, the City Council directed staff to provide an in-lieu housing fee analysis for their review and consideration at the second reading of the ordinance. The proposed in-lieu fee analysis has been presented to the City Council at a study session on February 27, 2024. During the study session, staff and Keyser Marston Associates (KMA) presented the proposed fee schedule as well as an explanation of the fee calculations. The City Council also received public comments, asked staff and KMA follow-up questions, and provided their comments on the proposed fees and overall vision for the proposed AHO.

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

- February 27, 2024 City Council Agenda Report: https://costamesa.legistar.com/View.ashx?M=F&ID=12707839&GUID=649FCC95-B510-4D3F-92E7-9C400FFFDF63

- February 27, 2024 City Council Meeting Video: https://costamesa.granicus.com/player/clip/4093?view_id=14&redirect=true

- February 27, 2024 City Council Public Comments: https://costamesa.legistar.com/View.ashx?M=E3&ID=1171565&GUID=B7C4B0DD-7AD7-4ADC-B8C3-392422409AF7

Public comments as well as the City Council's feedback from the February 27, 2024 study session expressed the need to ensure Costa Mesa is competitive with nearby cities and can attract housing developers for the creation of housing in the community. Discussions included comparing the City's proposed in-lieu fee amounts with the City of Santa Ana (who has seen success with their affordable housing program) and concerns that the City's proposed fee amounts were too high. The City's expert housing consultant, KMA, clarified that Santa Ana did not determine their in-lieu fee amounts based on a fee study or financial impact analysis; and therefore, is not equivalent to their onsite production requirements. In contrast, Costa Mesa's proposed fee amounts are derived from the proposed AHO requirements so that the fees are equivalent to producing the affordable units onsite. While the City Council could consider lowering the in-lieu fee amounts, doing so would result in less onsite production of affordable units, and housing developers would likely choose to pay the in-lieu fees instead. KMA also recommends that the AHO requirements should, therefore, also be lowered for the fee amount to be equivalent to the onsite production of affordable units.

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

Included with this Agenda Report is a fee resolution to adopt the in-lieu fee amounts (as shown in Table 3 below) with adoption of the AHO. The proposed fee amounts are based on the proposed AHO requirement set aside percentages.

Table 3 – Proposed Affordable Housing In-Lieu Fee Amounts

Recommended In-Lieu Fee Payment Schedule Per Square Foot of Total Leasable or Saleable Area in a Residential Development			
	Apartment Development		Ownership
	Density: 60+	Density: <60	Housing
Total Units	Units Per Acre	Units Per Acre	Development
15	$3.73	$1.97	$2.53
16	$7.46	$3.94	$5.06
17	$11.19	$5.91	$7.59
18	$14.91	$7.89	$10.11
19	$18.64	$9.86	$12.64
20	$22.37	$11.83	$15.17
21+	$26.10	$13.80	$17.70

To provide the City Council with additional comparisons of other cities' affordable housing in-lieu fee amounts, refer to Table 4. As shown in the table, there is no standard to establish an affordable housing in-lieu fee amount or fee structure. The in-lieu fees could be based on a sliding scale (as proposed in the AHO), flat fee per square foot, incremental increase over time, or a formula based on certain variables. The City of Encinitas more recently increased their fees from $20 per square foot to $23.79 per square foot. Encinitas also adjusts their fee administratively based on the percentage change in the most current Engineering News Record Construction Cost Index for the Los Angeles region. The City of San Diego adopted a program that included an incremental increase to their in-lieu fee amounts each fiscal year with the current fee set at $25 per square foot.

Table 4 – Comparison of Other Cities In-Lieu Fee Amounts

Encinitas	• 1 – 6 units: sliding scale[1] • 7+ units: $23.79 per sq. ft. • Affordability Requirement: ○ 10% Very Low or 15% Low
Irvine	• Formula based and calculated per project[2] • Affordability Requirement: ○ 5% Very Low + 5% Low + 5% Moderate

Long Beach	• Rental: $38 per sq. ft.
	• Ownership: $29.10 per sq. ft.
	• Affordability Requirement:
	  ○ 11% Very Low – Rental
	  ○ 10% Moderate – Ownership

Oceanside	• 2023 in-lieu fee set at $15 per sq. ft.
	• 2024 in-lieu fee increased to $20 per sq. ft.
	• Affordability Requirement:
	  ○ 10% Low – Rental
	  ○ 10% Moderate – Ownership

Santa Monica	• Rental: $35.70 per sq. ft. • Ownership: $41.70 per sq. ft.

	• Affordability Requirement: ○ 5% to 30% Very Low, Low, and Moderate

San Diego	• Incremental increase from July 1, 2020 through June 30, 2024[3]
	• 2024 in-lieu fee increased to $25 per sq. ft.
	• Affordability Requirement:
	  ○ 10% Very Low or Low – Rental
	  ○ 10 to 15% Moderate – Ownership

1 Sliding scale is based on a percentage of the adopted in-lieu fee amount depending on the number of units. For example, one unit project would be required to pay 14% of the in-lieu fee dollar amount. ***2*** Formula is based on land value, density, and percentage share of cost related to affordable units not being produced. ***3*** Prior to July 1, 2020, the in-lieu fee was established at $12.73 per sq. ft. and has increased every fiscal year (2021 - $15.18, 2022 - $17.64, 2023 – $20.09)	

Stakeholders Meeting on Proposed In-Lieu Fee Amounts

At the direction of the City Council, staff met with several housing developers in early March for additional feedback on the proposed in-lieu fee amounts. The housing developers included representatives from Irvine Company, City Ventures, Legacy, Sakioka Company, and Meritage Homes. These housing developers specialize in both for-sale homes within in-fill locations, and developers with experience in rental housing.

The housing developers provided their general thoughts on the City's proposed ordinance. The developers were supportive of the Planning Commission's recommendation to reduce the affordable requirement for the 60+ du/ac rental projects to 10% low or 5% very-low income. They stated that if the ordinance is adopted, housing developers will likely utilize the State's Density Bonus Law given the flexible incentives and waivers provided under the law. The State's Density Bonus would help developers achieve their project goals and return on investment. When asked about suggestions for any additional incentives that the City could provide, the developers identified expedited processing to reduce the entitlement and plan check time which would allow developers to commence construction at a faster pace and therefore reduce carrying costs. In this regard, the currently proposed AHO allows housing developers to simultaneously process construction plans while also processing their required entitlement planning applications.

The housing developers indicated that a high in-lieu fee amount would encourage the production of affordable housing units onsite. One of the for-sale housing developers with recent experience in developing for-sale units in Huntington Beach indicated that they did have success there with producing affordable units onsite within their market-rate project. However, that developer also mentioned that property owner equity is more difficult to build on the for-sale affordable units, as compared to market rate ownership. As such, they would prefer to pay an in-lieu fee. Developers stated that an in-lieu fee amount between $10 and $15 per leasable/saleable square feet would be the "breaking point" for a land development deal. However, it was acknowledged that it is difficult to determine an appropriate in-lieu fee amount because each housing project would have different variables (e.g., land costs, permitting review time, site preparation, and construction costs, etc.). In addition, changes in interest rates can significantly impact a developer's proforma. The developers also commented on the proposed "sliding scale fee" approach. While they understood that the sliding scale is intended to protect smaller projects with less units to "spread the cost", they felt that it may be punitive towards higher density housing projects that are building more units in the City. A flat fee, regardless of project size, was preferred. The developers did appreciate the option to pay a fractional in-lieu fee in a situation where the number of required units would result in a fraction.

State Density Bonus and Local Affordable Housing Program Strategies

It is important to note that residential developers can choose by right to use California's Density Bonus Law, which is codified in Government Code §65915 et seq. (State Density Bonus) for projects that adhere to the minimum criteria defined below:

- 5% units restricted to "Very Low Income"
- 10% units restricted to "Low Income" rental units or 10% "Moderate Income" for sale units
- 100% affordable units (excluding manager's units) with a maximum of 20% moderate units
- 10% "Very Low Income" units restricted for transitional foster youth, disabled veterans, or
- homeless
- 20% "Low Income" units for student housing at accredited colleges.
- A senior housing development.
- An age-restricted mobile home park
- The project donates at least one acre of land to the jurisdiction for very low-income units, the land has the appropriate permits and approvals, and has access to needed public facilities
- Projects which include a childcare facility

State Density Bonus allows for increased housing density on a property above the maximum allowed under the City's General Plan Land Use Element, a statutorily defined number of concessions/incentives, and potentially reductions and/or waivers to the City's development standards. The draft affordable housing ordinance is proposed to be designed to specifically include similar and in certain situations potentially greater housing development incentives than allowed by State Density Bonus Law. For example, the proposed AHO, while State Density Bonus requires the rents to be calculated based on 60% of AMI. In addition, the City's amended parking standards are proposed to be based on demonstrated market demand. The intention of the AHO is to create sufficient incentives through the proposed zoning code amendments to incentivize affordable housing construction that serves the local households at all income levels and is also consistent with the communities housing values.

Costa Mesa Community's Input on Need for Affordable Housing

More recently with the passage of Measure K (Ordinance to Revitalize Commercial and Industrial Areas and Protect Residential Neighborhoods), the Costa Mesa community recognized the impact of high housing costs in the City that has made it challenging to attract teachers, police officers, firefighters, and other professionals. During the community survey polling for the Measure K ballot initiative, the majority of Costa Mesa residents surveyed were in favor of addressing the City's housing needs as well as supporting more affordable housing options for all income levels. The Costa Mesa community has also identified that there is a benefit to provide an opportunity for current and future generations to find affordable housing in the community they grew up in. In the same community survey polling, residents also expressed support for an inclusionary housing requirement. The survey results from the community polling included the following findings:

- 81% in favor of addressing housing needs;
- 74% in favor of providing housing at all income levels for seniors, families, and young adults;

- 83% in favor of helping ensure more affordable housing is available for middle income and working-class families; and
- 71% in favor of requiring up to 15% of new and redeveloped housing units to be affordable housing.

Since the passage of Measure K, the Planning Division has also seen an increase in inquiries and interest in developing housing projects along the corridor areas. The Planning Division has received approximately 30 inquiries and met with many of these prospective housing developers which include City Ventures, Meritage Homes, and Toll Brothers. While Measure K promotes more housing development opportunities, it does not directly address the City’s housing affordability issues.

PUBLIC NOTICE:

Pursuant to Government Code Section 36933, a summary of the proposed Ordinance was published once in the newspaper no less than five days prior to the April 2, 2024 second reading. A summary of the adopted ordinance will also be published within 15 days after the adoption.

Pursuant to Government Code Section 66016, the proposed fee schedule and fee study was made available to the public 15 days prior to the April 2, 2024, City Council meeting.

Public comments received prior to the April 2, 2024 City Council meeting may be viewed at this link: CITY OF COSTA MESA - Calendar (legistar.com)

ALTERNATIVES:

The City Council may give second reading and adopt the Ordinance as proposed, modify the Ordinance, or not adopt the Ordinance. If the City Council chooses to make substantive modifications to the Ordinance, the modified Ordinance would need to return at a future meeting for second reading and adoption.

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

The City Council may also consider implementing the in-lieu fee schedule incrementally, similar to the City of San Diego. The City of San Diego set the in-lieu fee at a lower amount and over a five-year period, increased the fee to its eventual rate. The fee increased $12.27 over the five-year period. The fee is then updated annually based on the annual increase in the Construction Costs Index (CCI) published by Engineering News Record for Los Angeles, or similar construction industry index selected by the City Manager if the CCI index is discontinued. See Attachment 6, Information Bulletin 532, Requirements for Inclusionary Affordable Housing, City of San Diego. The Council could consider setting the fee at a lower rate and establish a schedule for increases over any specified period of time until the preferred maximum fee amount is met. For example, the Council may evaluate a fee of $12 in year one, with increases over a 10-year period to an eventual amount of $22.00 per applicable square foot and include an annual update to the fee based on CCI or similar construction industry index.

FISCAL REVIEW:

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

LEGAL REVIEW:

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

CONCLUSION:

Addressing housing needs for all income levels has been identified as one of the main housing goals by the Costa Mesa community and City Council. The community profile described in the 2021-2029 Housing Element showed that approximately half of Costa Mesa residents are overpaying for housing costs due to the lack of housing options especially affordable housing. Adoption of an Affordable Housing Ordinance would be a step towards addressing this issue coupled with the other Housing Element programs intended to remove or reduce existing barriers and constraints to market-rate housing developments. Furthermore, the ordinance would help towards achieving the City's RHNA for the very-low-, low-, and moderate-income categories. Its adoption would also fulfill the objective of Program 2A of the Housing Element and help achieve City Council's goal to "diversify, stabilize and increase housing to reflect community needs".