

# Inclusionary Housing Ordinance: Financial Evaluation

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# Inclusionary Housing Program Justification

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- In 2015, the California Supreme Court ruled in the *California Building Industry Association v. City of San Jose* case that Inclusionary Housing requirements should be viewed as use restrictions that are a valid exercise of zoning powers.
- Inclusionary Housing requirements must meet the following criteria:
  - The requirements cannot be “Confiscatory”; and
  - The requirements cannot deprive a property owner of a fair and reasonable return.

# Inclusionary Housing Program Justification

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- The adoption of AB 1505 in 2017 reopened the opportunity for the County to impose Inclusionary Housing obligations on rental housing.
- The legislation does not place a cap on the percentage of units that can be restricted, but it specifically identifies 15% of units at 80% of AMI as the target restriction.
- The KMA Financial Evaluation is intended to serve as an economic feasibility study that proves that the County's Inclusionary Housing Ordinance does not unduly constrain the production of housing.

# Supportable Inclusionary Housing Requirements

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# Impact of Inclusionary Housing Programs

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- No single program can solve the affordable housing crisis.
- Inclusionary housing programs can only be expected to fulfill a small piece of a community's affordable housing needs.
- As federal and state affordable housing resources continue to diminish, it is clear that community's need to take advantage of every opportunity to attract the development of affordable housing.

# RHNA Obligations at the End of 2018

Income Category	Total Obligation	Permits Issued	Remaining Obligation (Total)	Remaining Obligation (%)
Very Low	374	37	337	90%
Low	244	86	158	65%
Moderate	282	9	273	97%
Above Moderate	<u>641</u>	<u>993</u>	<u>(342)</u>	<u>0%</u>
Total	1,551	1,125	768	94%

# Market Conditions

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# Submarkets

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- Divergent demographic and real estate characteristics resulted in the need to create submarkets for use in the market study. Working with County staff the following submarkets were identified:

Big Sur	Ford Ord/East Garrison
Greater Carmel Valley	Greater Salinas
Greater Monterey Peninsula	South County
North County	

# Market Characteristics

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- Development in Monterey County ranges from urban centers located along the coast to single family home subdivisions and rural communities in the valleys.
- Only 25% of the total Monterey County population resides in unincorporated areas.
- Much of unincorporated Monterey County is either undeveloped or zoned for agricultural and open space uses.

# Market Study Results

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- Between 2008 and 2018, new housing in the unincorporated areas was dominated by the East Garrison projects.
- Major residential growth is not anticipated in the Coastal submarkets, but the development that occurs could support significant off-site affordable housing or in-lieu fee revenue.
- Based on historical precedent and property characteristics, KMA does not expect much residential development to occur in the Big Sur or South Count submarkets.

# Supportable Inclusionary Housing Requirements

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# Ownership Housing Affordability Gaps

Affordability Gap Calculations: Seven Submarkets				
Submarket	Very Low	Low	Moderate	Workforce 1
Big Sur	\$1.48 M	\$1.44 M	\$1.27 M	\$1.14 M
Greater Carmel Valley	\$1.22 M	\$1.16 M	\$998,100	\$864,600
Greater Monterey Peninsula	\$3.08 M	\$3.03 M	\$2.86 M	\$2.73 M
North County	\$730,100	\$672,700	\$505,600	\$372,100
Ford Ord/East Garrison	\$552,100	\$464,700	\$297,600	\$164,100
Greater Salinas	\$557,600	\$500,200	\$331,100	\$199,600
South County	\$532,100	\$474,700	\$307,600	\$174,100

# Findings:

## Ownership Housing Development Analysis

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- Given the size of the Affordability Gaps in the Big Sur, Carmel Valley, and Greater Monterey Peninsula submarkets it is not financially efficient to require on-site construction of comparable Inclusionary units.
- The Affordability Gaps in the four other submarkets and in a sample of recently developed projects are significantly lower, but still higher than the cost to assist leveraged affordable rental projects.
- These results highlight the need to create a flexible policy that allows for imposing cost efficient Inclusionary requirements.

# Rental Apartment Housing Analysis

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- KMA was not able to identify any recently constructed market rate apartment projects in unincorporated Monterey County.
- Existing market rate apartments are largely in small scale projects.
- Premium rents are being achieved for small units, but the overall average rents are insufficient to attract new development. The average rents required to attract development are estimated at:

One Bedroom	\$2,000
Two Bedrooms	\$2,800
Three Bedrooms	\$3,700

# Findings:

## Rental Apartment Analysis

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- KMA concluded that the project economics do not currently support development of market rate projects in the submarkets.
- This conclusion could change in the future and should be monitored by the County over time.
- Numerous 100% affordable rental projects have been developed in Monterey County. The consistent characteristic is the availability and use of outside leveraging sources.
- It is KMA's opinion that leveraged apartment units represent an excellent option for providing very low and low income apartments.



# Recommendations

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# Production of Inclusionary Housing Units

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- Developers should be allowed to split the production of the Inclusionary units into on-site and off-site locations.
- Irrespective of the tenure of the market rate project, off-site Inclusionary units should be required to be rental apartment units
- Developers should be required to produce moderate income and Workforce 1 units unless a hardship can be proven and Board of Supervisors approval is received.

# In-Lieu Fee Option

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- In-lieu fee payments should be allowed by right for projects with between 3 and 20 units.
- In-lieu fee payments should be allowed to be paid by right to fulfill the very low and low income unit requirements imposed by the Ordinance.
- In-lieu fee payment should be allowed for fractional unit requirements.
- In-lieu fee payment for projects with more than 20 units require a demonstrated hardship and Board of Supervisors approval.

# In-Lieu Fee Analysis

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- In-lieu fees should cover the net cost to provide the required Inclusionary units. Based on the affordability mix required by the Inclusionary Housing Ordinance, the in-lieu fees per affordable unit are estimated as follows:

Big Sur	\$335,100
Greater Carmel Valley	\$266,300
Greater Monterey Peninsula	\$732,000
North County	\$143,200
Fort Ord/East Garrison	\$91,200
Greater Salinas	\$100,100
South County	\$93,700

# Program Design Recommendations

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- The Ordinance should be re-evaluated at least once every five years to reflect changes in economics and demographics.
- The in-lieu fee amount should be adjusted each year to keep pace with changes in the market place. The adjustment should be based on a readily accessible source such as RERC.
- The County's Administrative Manual should be updated as needed to reflect changes to the Ordinance.
- A staffing plan should be created for managing the development process and ongoing monitoring.