Inclusionary Housing Ordinance: Financial Evaluation

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February 5, 2019

Inclusionary Housing Program Justification

Inclusionary Housing Program Justification

- 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

- 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

Impact of Inclusionary Housing Programs

- 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	641	993	(342)	0%
Total	1,551	1,125	768	94%

Market Conditions

Submarkets

- 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

- 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

- 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

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

- 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

- 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

- 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

Production of Inclusionary Housing Units

- 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

- 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

- 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

- 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.