

**CITY OF NEWPORT BEACH
CITY COUNCIL STAFF REPORT**

Agenda Item No. 20
April 27, 2010

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL

FROM: Planning Department
Jaime Murillo, Associate Planner
949-644-3209, jmurillo@newportbeachca.gov

SUBJECT: AMENDMENT TO TITLE 19, "SUBDIVISIONS", OF THE NEWPORT BEACH MUNICIPAL CODE, CODE AMENDMENT NO. CA2005-004 AND ADOPTION OF IN-LIEU HOUSING FEE (PA2005-062)

ISSUE

Should the City Council approve an amendment to Title 19 (Subdivisions) of the Newport Beach Municipal Code incorporating a new "Inclusionary Housing" chapter and establishing an in-lieu housing fee?

RECOMMENDATION

1. Introduce Ordinance No. 2010-____ amending Title 19, "Subdivisions", of the Newport Beach Municipal Code to incorporate Chapter 19.54 (Inclusionary Housing) establishing inclusionary housing requirements and an in-lieu housing fee (Attachment No. CC 1).
2. Adopt Resolution No. 2010-____ setting the amount of the in-lieu housing fee at \$18,500 per market-rate unit and establishing an annual adjustment to the fee (Attachment No. CC 2).

INTRODUCTION

The proposed chapter (Chapter 19.54) implements Housing Program 2.2.1 of the City's Housing Element which requires that an average of 15 percent of the units in a new residential development be affordable to persons of very low-, low-, or moderate-income, or that an equivalent in-lieu fee be paid. This program was adopted to promote construction of affordable dwelling units necessary to meet the "fair share" requirement set by the Regional Housing Needs Assessment (RHNA) developed by the Southern California Association of Governments.

Housing Program 2.2.1 reads as follows:

Require a proportion of affordable housing in new residential developments or levy an in-lieu fee. The City's goal over the five-year planning period is for an average of 15 percent of all new housing units to be affordable to very low-, low-, and moderate-income households. The City shall either (a) require the payment of an in-lieu fee, or (b) require the preparation of an Affordable Housing Implementation Plan (AHIP) that specifies how the development will meet the City's affordable housing goal, depending on the following criteria for project size:

- 1. Projects of 50 or fewer units shall have the option of preparing an AHIP or paying the in-lieu fee.*
- 2. Projects where more than 50 units are proposed shall be required to prepare an AHIP.*

Implementation of this program will occur in conjunction with City approval of any residential discretionary permits or Tentative Tract Maps. To insure compliance with the 15 percent affordability requirements, the City will include conditions in the approval of discretionary permits and Tentative Tract Maps to require ongoing monitoring of those projects. (Imp 2.1)

In the past, in-lieu housing fees paid to fulfill inclusionary housing program requirements have been in an amount negotiated with each developer. In an effort to calculate an equitable in-lieu fee option for residential developers, the City retained the services of Economic Planning Systems, Inc. (EPS) in 2004 to analyze and provide recommendations on the fees a residential developer should have to pay in lieu of providing affordable housing units. The City later retained the services of Keyser Marston Associates (KMA) in 2009 to update the recommendations and to prepare a financial constraints analysis to ensure the City's inclusionary housing requirements would not result in a financial burden to housing production in the City (Attachment No. CC 3).

Although Housing Program 2.2.1 is specific with regard to the criteria for when an in-lieu fee may be paid, the Housing Program does not provide direction to staff or to developers with regard to what an Affordable Housing Implementation Program entails, methods for satisfying the affordability requirement, or how the in-lieu fee shall be calculated. The proposed chapter provides the specific requirements necessary to implement the Housing Program and provides the legal basis for the in-lieu housing fee.

DISCUSSION

Basic Framework of Chapter 19.54 (Inclusionary Housing)

Applicability

The proposed chapter will only apply to residential projects for which a parcel map or a tract map is proposed (for-sale units). Residential projects proposed as rentals with no parcel map or tract map will not be subject to the inclusionary housing requirements. This distinction is based on a July 2009 court decision (Palmer/Sixth Street Properties L.P., et al., v. City of Los Angeles) in which the inclusionary housing requirements for

rental housing by the City of Los Angeles were invalidated. The court decided that the Costa-Hawkins Rental Housing Act (State law establishing apartment landlords' rights to set rents as they see fit) trumped the power of local authorities to require certain rental units to be made available at certain prices.

Staff's research of market-rate rental prices in the City found that a majority of the larger apartment complexes in the City were affordable to moderate-income households and a few complexes were affordable to low-income households. Accordingly, the assumption is that new residential projects proposed as rentals may be affordable to moderate-income households. Even if the units are not affordable to moderate-income households, rentals likely will provide more affordable options in the City than for-sale units.

Affordability Requirement

Affordable units are defined as dwellings restricted to occupancy by very low-, low-, or moderate-income households. Chapter 19.54 will require developers of residential subdivisions to facilitate production of affordable units in numbers equal to 15 percent of the number of for-sale market rate units produced. Affordable, for-sale units provided in compliance with this Chapter will be required to be sold at prices affordable for moderate-income households. If a subdivision proponent chooses to provide affordable rental units to comply with the Chapter, the units shall be rented at a rate affordable for very-low or low-income households. In all cases, the affordable units provided to meet the requirements of the Chapter shall be legally restricted to occupancy by, and affordable to, households of the income levels for which the affordable units were designated for a minimum duration of 30 years.

In order to provide flexibility to developers and reduce the burden that this Chapter may place on new residential subdivision projects, the following alternatives to the on-site construction requirements of the Chapter have been included:

1. *Off-Site Construction*- A developer may propose to construct all or some of the affordable units required by this Chapter at a location not physically within the residential subdivision project; however, the units must be located within the City boundaries.
2. *Off-Site Renovation*- A developer may propose to renovate and convert existing off-site units in the City to affordable units in lieu of constructing the affordable units required by the Chapter. The proposed units shall be subject to the following requirements:
 - a. The interiors and exteriors of the units shall be substantially renovated to improve the livability and aesthetics of the units for the duration of the affordability period.

- b. Renovations shall include energy conserving retrofits that will contribute to reduced housing costs for future occupants of the units.
- c. The units shall be returned to the City's housing supply as decent, safe and sanitary housing and meet all applicable housing and building code requirements.
- d. The units shall not already be subject to affordability income restrictions unless such restrictions are set to expire in 3 years or less. In such cases, the affordability covenant shall provide for 30 years in addition to any existing covenant time.

It should be noted that the conversion of market-rate units into affordable units as provided for by this Chapter would not be eligible to fulfill the City's RHNA "fair share" requirements. State Housing Law does include provisions that would allow for a portion of the RHNA requirement to be fulfilled through converted units; however, certain conditions would have to be included in this Chapter that would make implementation of this option difficult to implement (i.e., minimum affordability duration of 55 years, only units committed within first two years of the 5-year planning period are eligible, and specific relocation assistance requirements).

3. *Land Dedication* - A developer may propose to dedicate land to the City or a City-designated housing developer for the provision of affordable units in lieu of constructing some or all of the affordable units required by this Chapter. The Chapter includes specific site suitability requirements for the proposed land to be dedicated. In projects where the land dedication option is proposed, the City Council shall be the final review authority.
4. *In-Lieu Housing Fee* - For residential subdivision projects consisting of 50 or fewer dwelling units, the requirements of this Chapter may be satisfied by paying a fee in lieu of providing the required number of affordable units (on-site and/or off-site). The in-lieu fee shall be paid for each market-rate unit within the residential subdivision project and shall be paid prior to the issuance of a Building Permit. As explained in detail in the *In-Lieu Housing Fee Calculation* section of this report, the recommended in-lieu fee per market-rate unit has been calculated at \$18,500.

The payment of an in-lieu fee alone or in combination with the provision of a portion of the affordable units (on-site and/or off-site) may also be approved for residential subdivision projects consisting of more than 50 units, through the approval of an Affordable Housing Implementation Plan.

Affordable Housing Implementation Plan (AHIP)

An Affordable Housing Implementation Plan (AHIP) provides a description of the residential subdivision and the method of satisfying the affordable housing requirement. An AHIP shall be processed concurrently with the tentative tract map or parcel map application and shall be reviewed and approved by the applicable review authority for such maps. An AHIP is also a means to grant flexibility in satisfying the affordability requirement of this Chapter in one or more of the following ways:

- Providing very low-income units in exchange for a reduction in the number of required affordable units.
- Modification of the duration of affordability covenants to more than or less than 30 years, depending on the affordability level and number of provided affordable units.
- Project phasing.
- Providing a combination of affordable units on-site and off-site.
- Providing a portion of the affordable units (on-site and/or off-site) in combination with in-lieu fees.
- Payment of in-lieu fees for projects consisting of more than 50 units.

Payment of in-lieu housing fees for residential subdivision projects consisting of 50 or fewer units and consistent with all the provisions of the Chapter will not require an AHIP.

Affordable Housing Agreement

A condition of approval of an AHIP will include the recordation of an Affordable Housing Agreement. This agreement will restrict units for occupancy only by very low-, low-, or moderate-income households for a pre-determined number of years, as applicable. Rental unit restrictions shall be in the form of a regulatory agreement recorded against the applicable property. Owner-occupied units shall be subject to resale restrictions recorded against the applicable property.

Affordable Housing Fund

All funds received through the payment of in-lieu housing fees will be required to be deposited into an Affordable Housing Fund. The Fund shall be used in compliance with the General Plan Housing Element and this Chapter to construct, rehabilitate, or subsidize affordable housing or assist other governmental entities, private organizations or individuals to provide or preserve affordable housing. Specific allowed uses of fund monies are listed within proposed Chapter 19.54.

15 Percent Inclusionary Requirement

Prior to the 2006 General Plan Update, Housing Program 2.2.1 of the City's Housing Element required that an average of 20 percent of the units in a new residential development be affordable. During the preparation of the 2006 General Plan Update, Housing Program 2.2.1 was revised, reducing the inclusionary requirement to 15 percent.

Attachment No. CC 4 provides an analysis that demonstrates that a 15 percent inclusionary requirement is reasonable and is the minimum the City should consider to assist in meeting its RHNA goals. In fact, the analysis illustrates that approximately 47-percent of the City's expected development yield over the General Plan's remaining 21-year horizon would need to be affordable to moderate and lower-income households in order to achieve the estimated future RHNA goals. The estimated future RHNA is based on an assumption that the City's future RHNA goals will remain similar to the past two RHNA periods, with the second period reflecting a more aggressive adjustment by SCAG for higher-income communities.

Financial Constraints Analysis

The State Department of Housing and Community Development (HCD) has issued a letter (Attachment No. CC 5) stating that State housing element law is neutral relative to the enactment of mandatory inclusionary housing provisions; however, HCD is now requiring local governments to analyze mandatory inclusionary policies as a potential governmental constraint on housing production when adopting or updating housing elements.

In order to determine if the structure of the recommended Inclusionary Housing Chapter complies with State housing element law, KMA tested the financial burden associated with the proposed income and affordability restrictions.

For-sale: Moderate Income Affordability Requirement

Pro forma analyses were prepared to determine the primary financial burden created by imposing affordable housing requirements on for-sale units. The financial burden is defined as the difference between the achievable market rate prices and the allowable prices for the income restricted units. The pro forma analyses results indicate that the requirement to provide 15-percent of for-sale units for moderate income households reduces the supportable land value in the near term by 50-percent. A land value reduction in this range can be considered an onerous burden that will be an unreasonable constraint to residential development.

Rental: Low-Income Affordability Requirement

To mitigate the financial burden on for-sale developments, the proposed Inclusionary Housing Chapter provides the option for developers to fulfill the affordability requirements by providing rental units affordable to low-income households. In this case, the results of the pro forma analyses indicate that the proposed inclusionary requirements decrease the supportable land value of a residential development by 10-percent. This value decrease is much less than the primary financial burden typically associated with an inclusionary housing ordinance and is, therefore, determined not to be an unreasonable constraint.

Conclusion

The ability to provide rental units affordable to low-income households to fulfill the inclusionary requirements for a for-sale development project significantly reduces the financial burden to a level that does not constitute an unreasonable constraint. To corroborate this finding, KMA surveyed over 100 jurisdictions in California that currently impose inclusionary housing requirements and found that the primary financial burden associated with the proposed Inclusionary Housing Chapter is consistent with that of other inclusionary housing programs being implemented throughout the State. It was also noted that the inclusionary housing programs recently adopted in several California locations have been projected to generate land value reductions in the 30-percent range.

In-Lieu Housing Fee Calculation

To calculate a recommended in-lieu fee amount, KMA translated the financial burden generated by the inclusionary requirements into a per unit fee. Since it has been determined that the proposed inclusionary housing requirements are supportable and do not create an unreasonable constraint on residential housing development, KMA's methodology implicitly results in a reasonable in-lieu fee.

The KMA analysis is based on the assumption that developers will choose to fulfill the inclusionary housing requirements with rental units affordable to low-income households since this option would generate a substantially smaller financial burden. Thus, the in-lieu fee analysis was based on a rental housing scenario. Based on the results of the KMA analysis, the supportable in-lieu fee is equal to \$18,500 per market rate for-sale unit.

In-Lieu Housing Fee Adjustments

KMA has suggested an automatic annual adjustment to the in-lieu housing fee based upon the annual percentage change in new home prices in Orange County (from December to December) as published in the Real Estate Research Council report. This will ensure that the fees, at the time of payment, keep pace with inflation and the future

cost to construct affordable housing. The following illustrates the annual percentage change in new homes prices in Orange County over the last 10 years:

Annual Changes in New Home Prices in Orange County – 8 Year History			
Real Estate Research Council			
2008 - 2009	+ 1.5%	2004 – 2005	+ 8.7%
2007 – 2008	- 16.2%	2003 – 2004	+ 19.0%
2006 – 2007	-13.6%	2002 – 2003	+ 10.1%
2005 – 2006	- 1.6%	2001 – 2002	+ 10.7%

Building Industry Association Comments

The introduction of this ordinance was originally scheduled for the City Council's review on November 24, 2009. At the request of the Building Industry Association of Southern California (BIA), the item was pulled from the agenda to allow the BIA additional time to review the proposed ordinance and provide comment. On March 12, 2010, the BIA submitted a comment letter raising concerns that the proposed ordinance may conflict with State law (Attachment No. CC 6). The Office of the City Attorney has reviewed the case law cited in the BIA letter and believes that the proposed ordinance is consistent with applicable case law. The proposed inclusionary housing requirements strike a balance between the needs of the BIA's members and the City's goal of providing a wide range of housing options to our residents.

ENVIRONMENTAL REVIEW

The proposed action is not defined as a project and does not require environmental review under the California Environmental Quality Act (CEQA) because it involves general policy and procedure making activities not associated with a project and does not have the potential for resulting in a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment (Section 15378 of the CEQA Guidelines).

PUBLIC NOTICE

Notice of this hearing was made by posting the Council Agenda on the City's official notice bulletin board and posting the agenda and report on the City's Website. Notice of the time and place of the hearing, including the address where the information could be reviewed, was also posted on the City's official notice bulletin board, and mailed to the Building Industry Association of Southern California, Orange County Chapter per their written request not less than 14 days prior to the hearing. In addition, an e-mail

notification of this meeting was sent to all interested parties on the City's Housing Interest List.

ALTERNATIVES

- 1) The City Council may suggest changes to the proposed code amendment and/or resolution establishing the in-lieu housing fee. Should the City Council choose to do so, staff will return with a revised resolution and/or ordinance incorporating these changes.

- 2) Deny the proposed code amendment and resolution.

Submitted by:

Prepared by:


David Lepo
Planning Director


Jaime Murillo
Associate Planner

Attachments:

- CC 1 Draft Ordinance Amending Title 19
- CC 2 Draft Resolution setting the amount of the in-lieu fee
- CC 3 Keyser Marston Associates (KMA) Analysis of Inclusionary Housing Options
- CC 4 Estimated Future RHNA Goals
- CC 5 State Department of Housing and Community Development Letter
- CC 6 Building Industry Association of Southern California Letter (March 12, 2010)

Attachment No. CC 1
Draft Ordinance Amending Title 19

ORDINANCE NO. 2010-__

**AN ORDINANCE OF THE CITY COUNCIL OF THE CITY OF
NEWPORT BEACH INCORPORATING A NEW
INCLUSIONARY HOUSING CHAPTER (CHAPTER 19.54)
INTO TITLE 19 OF THE NEWPORT BEACH MUNICIPAL
CODE.**

WHEREAS, the City of Newport Beach ("City") is a charter city, governed by a charter adopted by the citizens of the City; and

WHEREAS, it is a public purpose of the City and a policy of the State to achieve a diverse and balanced community with housing available for households of all income levels; and

WHEREAS, economic diversity fosters social and environmental conditions that protect and enhance the social fabric of the City and is beneficial to the health, safety and welfare of its residents; and

WHEREAS, the lack of affordable housing has a direct impact upon the health, safety and welfare of the residents of the City;

WHEREAS, State law pertaining to General Plans and the Housing Element of the City General Plan require that City ordinances regulate land use development and that the City otherwise use its authority in a manner that provides an adequate supply of housing for all economic segments of the community; and

WHEREAS, the City is experiencing a shortage of housing affordable to very low-, low- and moderate-income households and will not be able to fully contribute to the attainment of the State housing goals or to retain a healthy environment without additional affordable housing; and

WHEREAS, new residential development generally does not provide housing opportunities for very low-, low- and moderate-income households due to the high cost of land in the City; and

WHEREAS, an increasing number of persons in very low-, low, and moderate-income households live in overcrowded or substandard housing and devote an overly large percentage of their income to pay for housing; and

WHEREAS, the amount of land in the City available for residential development is limited; and

WHEREAS, the consumption of this remaining land for residential development without providing housing affordable to persons of all income levels would be contrary to

housing, environmental and planning policies and have a substantial negative impact on the environment and economic climate because (i) housing will have to be built elsewhere, far from employment centers and, therefore, commutes will increase, causing increased traffic and transit demand and consequent noise and air pollution; and (ii) City businesses will find it more difficult to attract and retain the workers they need; and

WHEREAS, new residential development in the City that does not provide for affordable units aggravates the existing shortage of affordable housing by absorbing the supply of available residential land, reducing the supply of land for affordable housing and increasing the price of the remaining residential land; and

WHEREAS, at the same time, new residential development contributes to the demand for goods and services in the City, increasing local service employment at wage levels which often do not permit employees to afford housing in the City; and

WHEREAS, Federal and State funds for the construction of new affordable housing are insufficient to fully address the problem of affordable housing within the City; and

WHEREAS, the private housing market has failed to provide adequate housing opportunities for very low-, low-, and moderate- income households; and

WHEREAS, the City is aware that there may be times when the inclusionary housing requirements make market-rate housing more expensive; and

WHEREAS, in weighing all the factors, including the significant need for affordable housing, the City Council has made the decision that the community's interests are best served by the adoption of inclusionary housing regulations; and

WHEREAS, to implement the City's General Plan, to carry out the policies of the State and Federal law and policy, and to ensure the benefits of economic diversity of the residents of the City, it is essential that new residential development in the remaining new growth areas of the City contain housing opportunities to households of very low-, low- and moderate-income, and that the City provide a regulatory framework which ensures development of an adequate supply and mix of new housing to meet the future housing needs of all income segments of the community; and

WHEREAS, in July of 2006, the City Council adopted an update to the City's General Plan, which includes a Housing Element that addresses issues, goals, and policies related to ensuring an adequate supply of housing opportunities for all residents; and

WHEREAS, with the intent of achieving the City's Regional Housing Needs Assessment (RHNA) construction goals and to encourage the housing development industry to respond to the housing needs of the community and demand for affordable

housing, the City updated its longstanding inclusionary housing program and incorporated it into the 2006 Housing Element Update (Housing Program 2.2.1); and

WHEREAS, Housing Program 2.2.1 is a statement of the City's inclusionary housing policy and requires the preparation of an Affordable Housing Implementation Plan (or the payment of an in-lieu fee) when the construction of new units are proposed; and

WHEREAS, the City Council finds that it is necessary to adopt an inclusionary housing ordinance to implement Housing Program 2.2.1 and to address the City's housing shortage; and

WHEREAS, notice of this hearing was made by posting the Council Agenda on the City's official notice bulletin board and posting the agenda and report on the City's Website. Notice of the time and place of the hearing, including the address where the information could be reviewed, was also posted on the City's official notice bulletin board, and mailed to the Building Industry Association of Southern California, Orange County Chapter per their written request not less than 14 days prior to the hearing. In addition, an e-mail notification of this meeting was sent to all interested parties on the City's Housing Interest List.

NOW THEREFORE, the City Council of the City of Newport Beach, California, hereby ordains as follows:

SECTION 1: Chapter 19.54 of the Newport Beach Municipal Code is hereby added to Title 19 to read as shown in Exhibit 1, which is attached hereto and incorporated by reference into this ordinance. All other provisions of Title 19 of the Newport Beach Municipal Code shall remain unchanged.

SECTION 2: If any section, subsection, sentence, clause or phrase of this ordinance is, for any reason, held to be invalid or unconstitutional, such decision shall not affect the validity or constitutionality of the remaining portions of this ordinance. The City Council hereby declares that it would have passed this ordinance, and each section, subsection, clause or phrase hereof, irrespective of the fact that any one or more sections, subsections, sentences, clauses and phrases be declared unconstitutional.

SECTION 3: The proposed action is not defined as a project and does not require environmental review under the California Environmental Quality Act (CEQA) because it involves general policy and procedure making activities not associated with a project and does not have the potential for resulting in a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment (Section 15378 of the CEQA Guidelines); and

SECTION 4: The Mayor shall sign and the City Clerk shall attest to the passage of this Ordinance. This Ordinance shall be published once in the official newspaper of the City, and the same shall become effective thirty (30) days after the date of its

adoption.

SECTION 5: This Ordinance was introduced at a regular meeting of the City Council of the City of Newport Beach held on the 27th day of April, 2010, and adopted on the 11th day of May, 2010, by the following vote, to wit:

AYES, COUNCIL MEMBERS _____

NOES, COUNCIL MEMBERS _____

ABSENT, COUNCIL MEMBERS _____

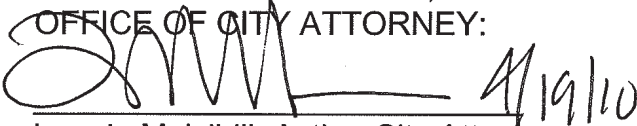
MAYOR

Keith Curry

ATTEST:

Leilani Brown, City Clerk

APPROVED AS TO FORM,
OFFICE OF CITY ATTORNEY:

 4/19/10

Leonie Mulvihill, Acting City Attorney
for the City of Newport Beach

EXHIBIT 2

CHAPTER 19.54

INCLUSIONARY HOUSING

Sections:

- 19.54.010 Purpose
- 19.54.020 Definitions
- 19.54.030 Applicability
- 19.54.040 Regulations
- 19.54.050 In Lieu Fees
- 19.54.060 Affordable Housing Implementation Plan (AHIP)
- 19.54.070 Alternatives to On-Site Construction
- 19.54.080 Affordable Housing Agreement
- 19.54.090 Affordable Housing Fund
- 19.54.100 Adjustments, Waivers

19.54.010 Purpose

The purpose of this Chapter is to:

- A. Provide a balanced residential community comprised of a variety of housing types and opportunities for all social and economic segments, including very low-, low-, and moderate-income households;
- B. Promote the City's goal to add affordable housing units to the City's housing stock in proportion to the overall increase in new housing units;
- C. Offset the demand on housing that is created by residential development and mitigate environmental and other impacts that accompany residential development by protecting the economic diversity of the City's housing stock, reducing traffic, transit and related air quality impacts, promoting jobs/housing balance and reducing the demands placed on transportation infrastructure in the region; and
- D. Ensure that the limited remaining developable land in the City's planning area is utilized in a manner consistent with the Housing Element.

19.54.020 Definitions

For the purposes of this Chapter and this Title, the following terms shall have the meanings indicated:

- A. Affordable Housing Agreement. The agreement entered into in compliance with Section 19.54.080 which provides legal restrictions by which the affordable units shall be restricted to ensure that the unit remains affordable to very low-, low-, or moderate-income households, as applicable. With respect to rental units, rent restrictions shall be in the form of a regulatory agreement recorded against the applicable property. With respect to owner-occupied units, resale controls shall

be in the form of resale restrictions, deeds of trust, and/or other similar documents recorded against the applicable property.

- B. Affordable Housing Implementation Plan (AHIP). A plan prepared in compliance with Section 19.54.060 which provides a description of the residential subdivision and method of satisfying the affordable housing requirement.
- C. Affordable Housing Price. A sales price that is no more than 3 times the maximum income level for very low-, low-, and moderate-income households. In determining the maximum household income for a given affordable unit, it shall be assumed that each bedroom is occupied by two persons, except for efficiency units (one person).
- D. Affordable Rental Price. An annual rent that does not exceed 30 percent of maximum income level for very low-, low-, and moderate-income households, as adjusted for household size. In determining the maximum household income for a given affordable unit, it shall be assumed that each bedroom is occupied by two persons, except for efficiency units (one person).
- E. Affordable Unit. An ownership or rental-housing unit, including senior housing, affordable to households with very low-, low-, and moderate-incomes as defined in this Chapter.
- F. Conversion. A change of a dwelling unit to a condominium, cooperative, or a similar form of ownership, or to a nonresidential use.
- G. Low-income. Income between 50% and 80% of the Orange County median income, adjusted for actual household size, as determined by the California Department of Housing and Community Development.
- H. Moderate-income. Income between 80% and 120% of the Orange County median income, adjusted for actual household size, as determined by the California Department of Housing and Community Development.
- I. Very low-income. Income 50% or less of the Orange County median income, adjusted for actual household size, as determined by the California Department of Housing and Community Development.

19.54.030 Applicability

Residential subdivision projects that result in a net increase in the number of units on the property shall comply with the requirements of this Chapter, unless granted an adjustment or waiver in compliance with Section 19.54.100 (Adjustments, Waivers). The provisions of this Chapter shall not apply to nonresidential subdivisions, nor to condominium projects or stock cooperatives which consist of the subdivision of air space in an existing apartment building which, at the time of tentative map filing, is five or more years old.

19.54.040 Regulations

A. Affordability Requirement.

1. Residential subdivision projects subject to this Chapter shall include the construction of 15% of the net increase number of dwelling units within the residential development project as affordable units restricted for occupancy by very low-, low- or moderate-income households. Notwithstanding the construction requirements, alternatives to on-site construction may be provided pursuant to Section 19.54.070 (Alternatives to On-Site Construction). A lower percent of affordable units may be approved as part of an AHIP if the project includes units for very low-income households.
2. The affordability requirement shall apply only to the net increase of residential units on the property. In the event that the residential subdivision project includes the demolition or conversion of existing residential units, except as provided in Chapter 20.86 of the Zoning Code (Low and Moderate Income Housing within the Coastal Zone), the affordability requirement shall only apply to the net increase of residential units on the property.
3. Affordable units required to be replaced under the provisions of Chapter 20.86 of the Zoning Code (Low and Moderate Income Housing within the Coastal Zone) shall not be eligible for fulfilling the number of affordable units required under the provisions of this Chapter.
4. The number of affordable units required for a residential subdivision project shall be determined by the review authority prior to tentative or parcel map approval.
5. To determine the number of units required when new affordable units are to be provided, any decimal fraction less than 0.50 shall be rounded down to the nearest whole number, and any fraction greater than or equal to 0.50 shall be rounded up to the next whole number. Provided, in no case shall the affordability requirement be zero.

B. For-Sale Price, Rent, of Affordable Units. For affordable for-sale units provided in compliance with this Chapter, the applicant shall sell the units at a housing price affordable for moderate-income households. If the applicant chooses to provide affordable rental units to comply with this Chapter, the applicant shall rent the units at a rental price affordable for very low- or low-income households.

C. Duration of Affordability Requirement. Affordable units required by this Section shall be legally restricted to occupancy by, and affordable to, households of the income levels for which the affordable units were designated for a minimum duration of 30 years, or as provided in an approved AHIP.

- D. Timing. Affordable units shall be provided and offered for occupancy concurrently with or prior to the occupancy of the market-rate units. For projects that are phased over time, affordable units shall be provided in accordance with an approved AHIP.

19.54.050 In Lieu Fees

A. General Requirements.

1. For residential subdivision projects of 50 or fewer dwelling units, the requirements of this Chapter may be satisfied by paying a fee in lieu of providing all or a portion of the affordable units, unless otherwise provided by an approved AHIP.
2. For residential subdivision projects of 51 dwelling units or more, the applicant may not pay a fee in lieu of constructing the required affordable units, unless otherwise provided by an approved AHIP.

- B. In-Lieu Fee Payment. When a fee is being paid in lieu of providing affordable units, the in-lieu fee shall be paid for each market-rate unit within the residential subdivision project.

- C. Timing of Payment. Payment of the in-lieu fee shall be made prior to the issuance of a Building Permit, unless otherwise provided by an approved AHIP.

- D. Amount of Fee. The amount of the in-lieu fee shall be set by resolution of the Council.

19.54.060 Affordable Housing Implementation Plan (AHIP)

A. When Required.

1. Residential subdivision projects of 51 dwelling units or more shall be required to submit an AHIP.
2. Residential subdivision projects of 50 or fewer dwelling units shall have the option of submitting an AHIP or paying an in-lieu fee.

B. Contents. The AHIP shall contain the following information:

1. A description of the residential subdivision, including the number of market rate and affordable units proposed, and the basis for the calculation of the number of required affordable units;
2. The method of satisfying the affordable housing requirement, including the income level(s) and tenure of the affordable units to be provided;
3. A phasing plan, if the applicant proposes a phased project, that provides for the timing of development of the affordable units;

4. Information necessary to establish compliance with criteria provided in Subsection 19.54.070.B (Off-Site Renovation Projects) or Subsection 19.54.070.C (Land Dedication), if applicable; and
 5. Any additional information requested by the Planning Director to assist in the evaluation of the AHIP.
- C. Approval.
1. The review authority for the project shall approve, conditionally approve, or deny the AHIP on the basis of the application, plans, materials, and testimony submitted.
 2. If the AHIP proposes the dedication of land in compliance with Subsection 19.54.070.C (Land Dedication) the City Council shall be the final review authority. In these cases, the Planning Commission shall first recommend and the City Council shall approve, conditionally approve, or deny the AHIP.
- D. Appeal of review authority's decision. The decision of the review authority may be appealed in compliance with Chapter 20.95 (Appeals).

19.54.070 Alternatives to On-Site Construction

The following alternative means of compliance with this Chapter may be considered as part of an AHIP.

- A. Off-Site Construction Projects. An applicant may propose to construct some or all of the affordable units required by this Chapter at a location not physically within the residential subdivision project; however, the affordable units shall be located within the City boundaries.
- B. Off-Site Renovation Projects. An applicant may propose to renovate and convert existing off-site units in the City to affordable units in lieu of constructing some or all of the affordable units required by this Chapter. The proposed units shall meet the following requirements:
1. The interiors and exteriors of the units shall be substantially renovated to improve the livability and aesthetics of the units for the duration of the affordability period.
 2. The units shall be returned to the City's housing supply as decent, safe and sanitary housing and meet all applicable housing and building code requirements.
 3. Renovations shall include energy conserving retrofits that will contribute to reduced housing costs for future occupants of the units.

4. The units shall not already be subject to affordability income restrictions unless such restrictions are set to expire in 3 years or less. In such cases, the affordability covenant shall provide for 30 years in addition to any existing covenant time.
- C. Land Dedication. An applicant may propose to dedicate land to the City or to a City-designated housing developer for the provision of affordable units in lieu of constructing some or all of the affordable units required by this Chapter. The dedicated land shall meet the following site suitability requirements:
1. The dedicated land shall be useable for its intended purpose and have the appropriate General Plan and zoning designation for the development of affordable housing, be free of toxic substances and contaminated soils, be fully improved with infrastructure and adjacent utilities necessary to serve the project, and shall have no title restrictions that would prevent the development of the required number of affordable units.
 2. Title to the dedicated land, or lease hold for the useful life of the housing improvements, shall be conveyed to the City or City-designated housing developer before a Building Permit is issued for any portion of the residential subdivision project.
 3. All property taxes, special taxes, fees, or other assessments shall be current before the title is conveyed.
 4. The dedicated land shall be sufficient in size to construct the number of affordable units that the applicant would otherwise be required to construct.
- D. Findings and Decision. The review authority may approve or conditionally approve, an AHIP that proposes alternative means of compliance with the requirements of this Chapter after first finding all of the following:
1. The purpose of this Chapter would be served by the implementation of the proposed alternative;
 2. The units provided are located within the City and are consistent with the requirements of this Chapter; and
 3. It would not be feasible or practical to construct the units on-site.

19.54.080 Affordable Housing Agreement.

An affordable housing agreement shall be executed in a recordable form prior to the issuance of a Building Permit for any portion of a residential subdivision project subject to the requirements of this Chapter.

A. Contents. Affordable housing agreements shall include the following where applicable:

1. A description of the residential subdivision project, how the affordable housing requirements will be met by the applicant, and whether the affordable units will be rented or owner-occupied;
2. The number, size, and location of each affordable unit;
3. Incentives provided by the City (if any) for density bonus;
4. Limits on income, rent and sales price of affordable units;
5. Procedures for tenant selection and the process for qualifying prospective households for income eligibility;
6. Provisions and/or documents for resale restrictions, deeds of trust, rights of first refusal for owner-occupied units, or restrictions for rental units;
7. Provisions for monitoring the ongoing affordability of the units;
8. Performance guarantees (e.g., a cash deposit, bond, or letter of credit) as required by the review authority; and
9. Provisions for the enforcement and penalties for violation of the agreement.

B. Recording of Agreement. Affordable housing agreements in a form acceptable to the City Attorney shall be recorded against the owner-occupied affordable units and the projects containing rental affordable units. Additional rental or resale restrictions, deeds of trust, rights of first refusal and/or other documents shall also be recorded against owner-occupied affordable units. In cases where the requirements of this Chapter are satisfied through the development or renovation of off-site units, the affordable housing agreement shall simultaneously be recorded against the property where the off-site units are located.

19.54.090 Affordable Housing Fund

A. Fund Revenues. The fund shall receive all in-lieu fees paid under Section 20.34.050 (In-Lieu fees) and may also receive monies from other sources.

B. Purpose and Limitations. Affordable Housing Fund monies shall be used in compliance with the General Plan Housing Element and this Chapter to construct, rehabilitate, or subsidize affordable housing or assist other governmental entities, private organizations or individuals to provide or preserve affordable housing. The fund may be used for the benefit of both rental and owner-occupied housing. Allowed uses of fund monies include:

1. Assistance to housing development corporations;

2. Equity participation loans;
3. Grants;
4. Pre-home ownership co-investment;
5. Predevelopment loan funds;
6. Participation leases;
7. Other public-private partnership arrangements;
8. The acquisition of property and property rights;
9. Construction of affordable housing including costs associated with planning, administration, and design, as well as actual building or installation;
10. Costs of rehabilitation and maintenance of existing affordable housing when needed to preserve units that are at risk of going to a market rate or at risk of deterioration;
11. Other costs associated with the construction or financing of affordable housing;
13. Reasonable administrative charges or related expenses; and
14. Reasonable consultant and legal expenses related to the establishment and/or administration of the fund.

19.54.100 Adjustments, Waivers

The City Council may waive, wholly or partially, the requirements of this Chapter and approve alternative methods of compliance with this Chapter if the applicant demonstrates, and the City Council finds that either:

- A. Taking. There is no reasonable relationship between the impact of a proposed development and the requirements of this Chapter and applying the requirements of this Chapter would take property in violation of the United States or California Constitutions; or

- B. Special circumstances. There are special circumstances unique to the residential development that justify the granting of an adjustment or waiver; the residential development would not be feasible without the modifications; a specific and financial hardship would occur if the modification was not granted; and no alternative means of compliance are available that would be effective in attaining the purpose of this Chapter than the relief requested.

Attachment No. CC 2
Draft resolution setting in-lieu fee amount

RESOLUTION NO. 2010-____

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF
NEWPORT BEACH SETTING THE AMOUNT OF THE
AFFORDABLE HOUSING IN-LIEU FEE PURSUANT TO
SECTION 19.54.050(D) OF THE NEWPORT BEACH
MUNICIPAL CODE**

WHEREAS, in July of 2006, the City Council adopted an update to the City of Newport Beach's ("City") General Plan, which includes a Housing Element that addresses issues, goals, and policies related to ensuring an adequate supply of housing opportunities for all residents; and

WHEREAS, with the intent of achieving the City's Regional Housing Needs Assessment construction goals and encouraging the housing development industry to respond to the housing needs of the community and the demand for affordable housing, the 2006 Housing Element Update (Housing Program 2.2.1) incorporates the City's longstanding inclusionary housing policy; and

WHEREAS, Housing Program 2.2.1 is a statement of the City's inclusionary housing policy and requires the preparation of an Affordable Housing Implementation Plan, or the payment of an in-lieu fee, when the construction of new units is proposed; and

WHEREAS, Chapter 19.54 of the Newport Beach Municipal Code implements Housing Program 2.2.1 and establishes an affordable housing requirement requiring that 15-percent of the total number of dwelling units required in conjunction with residential subdivisions be affordable to very low-, low- or moderate-income households; and

WHEREAS, to increase the flexibility in the means of fulfilling inclusionary housing requirements, Chapter 19.54 provides the option of paying a fee in lieu of providing the affordable units within residential subdivision projects; and

WHEREAS, in an effort to provide an equitable in-lieu fee option to residential developers, the City retained the services of Economic Planning Systems, Inc. (EPS), in 2004 to analyze and provide recommendations on the fees a residential developer should have to pay in lieu of providing affordable housing units; and

WHEREAS, the City retained the services of Keyser Marston Associates (KMA) in 2009 to update the EPS in-lieu fee recommendations and to prepare selected analyses of the financial burden associated with income and affordability restrictions that may be imposed under the requirements of Chapter 19.54 (Exhibit A); and

WHEREAS, such financial analyses indicated the inclusionary housing requirements can be fulfilled without creating an unreasonable constraint on residential development; and

WHEREAS, the KMA in-lieu fee analysis is based on the assumption that the City will provide developers with the option to fulfill the inclusionary requirements with either ownership or rental units; and

WHEREAS, the analysis further indicates that the provision of affordable rental units generates a substantially smaller financial burden than the provision of affordable ownership units, and, accordingly, the in-lieu fee analysis is based on a rental housing scenario; and

WHEREAS, KMA projected the financial burden imposed on a typical new residential subdivision by the inclusionary requirements into an equivalent per unit in-lieu fee; and

WHEREAS, the results of the in-lieu fee analysis indicate that the financial burden incurred providing low-income rental units pursuant to the provisions of Chapter 19.54 translates to an in-lieu fee of \$18,500 per market rate ownership unit; and

WHEREAS, the City Council has reviewed the financial analyses and methodology used to establish the in-lieu housing fee, and determines the in-lieu fee to be appropriate; and

WHEREAS, the proposed action is not defined as a project under the California Environmental Quality Act (CEQA) because it involves general policy and procedure making activities not associated with a project or a physical change in the environment (Section 15378 of the CEQA Guidelines); and

WHEREAS, notice of this hearing was made by posting the Council Agenda on the City's official notice bulletin board and posting the agenda and report on the City's Website. Notice of the time and place of the hearing, including the address where the information could be reviewed, was also posted on the City's official notice bulletin board, and mailed to the Building Industry Association of Southern California, Orange County Chapter per their written request not less than 14 days prior to the hearing. In addition, an e-mail notification of this meeting was sent to all interested parties on the City's Housing Interest List.

NOW THEREFORE, the City Council of the City of Newport Beach, California, hereby resolves as follows:

SECTION 1: The in-lieu housing fee pursuant to Section 19.54.050 (D) of the Newport Beach Municipal Code is set at Eighteen Thousand Five Hundred Dollars (\$18,500).

SECTION 2: The in-lieu housing fee shall be increased automatically, based upon the annual percentage change in the new home prices in Orange County (from December to December) as published in Real Estate Research Council report in order to ensure that the fees keep pace with inflation and the cost to construct affordable housing.

SECTION 3: This Resolution passed and approved at a regular meeting of the City Council of the City of Newport Beach held on the 27th day of April, 2010, by the following vote, to wit:

AYES, COUNCIL MEMBERS _____

NOES, COUNCIL MEMBERS _____

ABSENT, COUNCIL MEMBERS _____

MAYOR

Keith Curry

ATTEST:

Leilani Brown, City Clerk

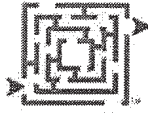
EXHIBIT A

Keyser Marston Associates Analysis of Inclusionary Housing
Options

(To Be Inserted)

Attachment No. CC 3

KMA Analysis



KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

ADVISORS IN:
REAL ESTATE
REDEVELOPMENT
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

SAN FRANCISCO
A. JERRY KEYSER
TIMOTHY C. KELLY
KATE EARLE FUNK
DEBBIE M. KERN
ROBERT J. WETMORE
REED T. KAWAHARA

LOS ANGELES
KATHLEEN H. HEAD
JAMES A. RABE
PAUL C. ANDERSON
GREGORY D. SOO-HOO
KEVIN E. ENGSTROM
JULIE L. ROMEY
DENISE BICKERSTAFF

SAN DIEGO
GERALD M. TRIMBLE
PAUL C. MARRA

To: Sharon Wood, Assistant City Manager
City of Newport Beach

From: Kathleen Head

Date: September 17, 2009

Subject: Analysis of Inclusionary Housing Options

At your request, Keyser Marston Associates, Inc. (KMA) prepared selected financial analyses pertaining to the City of Newport Beach (City) Inclusionary Housing Program. These analyses can be described as follows:

1. The inclusionary housing requirements are proposed to be imposed on new ownership residential development. Market rate rental projects are not proposed to be subject to the Inclusionary Housing Program requirements.
2. The proposed Program will allow the income and affordability requirements to be fulfilled in any of the following ways:
 - a. On-site development of units within the proposed market rate ownership residential development; or
 - b. Development of income restricted rental units; or
 - c. Payment of a fee to the City in lieu of developing any income restricted housing units.
3. KMA tested the financial impacts associated with income and affordability restrictions that may be imposed under the Inclusionary Housing Program. Based on that analysis, KMA identified an Inclusionary Housing Program structure that does not create an onerous burden on residential development. The recommended structure is intended to comply with the State of California (State) Housing Element requirement that the program should not create an unreasonable constraint on residential development.

To: Sharon Wood, City of Newport Beach
Subject: Analysis of Inclusionary Housing Options

September 17, 2009
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BACKGROUND STATEMENT

The City has applied an inclusionary housing requirement on a case-by-case basis for new residential development for more than 20 years. This requirement is currently being formalized into an ordinance that will impose specific restrictions on future new ownership residential development. As part of the process, the City engaged Economic & Planning Systems, Inc. to prepare an "Inclusionary Housing In-Lieu Fee Study" (EPS Study). This study was completed in October 2008.

KMA was recently engaged by the City to test the financial impacts associated with the proposed requirements. The ultimate objective of the KMA analysis is to create Inclusionary Housing Program terms that fulfill the City's affordable housing objectives without eliminating the developer's economically beneficial use of the property.

KMA tested the following baseline inclusionary housing obligations:

1. Threshold requirement: 15% of the units in market rate ownership residential development are subject to income and affordability restrictions.
2. Household Income Restrictions:
 - a. If ownership units are provided to fulfill the obligation, the restricted units must be allocated to moderate income households.
 - b. If rental units are provided to fulfill the obligation, the restricted units must be rented to low income households.

KMA prepared pro forma analyses of prototypical product types to estimate the financial impact created by imposing the identified inclusionary housing requirements. The analyses compare baseline market rate project pro formas to pro formas for projects that meet the inclusionary standards. These comparisons are used to quantify the financial impacts created by the requirements being tested.

KMA also reviewed the characteristics of inclusionary housing ordinances currently in place throughout California. The purpose of this survey is to provide further assistance in determining whether the requirements being considered by the City fall within the range of other existing ordinances.

PRO FORMA ANALYSIS ORGANIZATION

A summary of the analysis is presented in Table 1. The supporting pro forma analyses are organized as follows:

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Subject: Analysis of Inclusionary Housing Options

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Appendix A: Affordable Housing Cost Calculations
Appendix B: Ownership: Baseline Market Rate Project
Appendix C: Ownership: Moderate Income Inclusionary
Appendix D: Rental: Baseline Market Rate Project
Appendix E: Rental: Low Income Inclusionary

ANALYSIS ASSUMPTIONS

Ownership Assumptions

KMA reviewed ownership residential projects that have recently been submitted to the City's Planning Department to identify the product type to use as the baseline market rate project scenario. Based on the available information, KMA created a prototype project with the following characteristics:

1. The development site is set at two acres.
2. The prototype project includes 32 units, which represents a density of 16-units per acre.
3. The average unit size is set at approximately 2,100 square feet.

The pro forma analyses are based on the following assumptions:

1. The construction costs, excluding land acquisition costs, are estimated at \$1.2 million per unit.
2. The average sales price for the market rate units is projected at \$1.8 million per unit.
3. Based on the affordable housing cost calculation methodology defined in the City's Housing Element, the 2009 affordable purchase price for a three-bedroom unit is approximately \$360,000 (See Appendix A-Table 1).
4. The threshold developer profit is set at 15% of the project's construction costs.

Rental Assumptions

The rental prototype being tested in the KMA financial analysis is based on a survey of apartment complexes in Newport Beach. The key components of the prototype project are:

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1. The development site is set at two acres.
2. The prototype project includes 36 units, a density of 18-units per acre.
3. The project includes the following unit mix:
 - a. 40% one-bedroom units;
 - b. 40% two-bedroom units; and
 - c. 20% three-bedroom units.

The following assumptions are used in the rental scenarios:

1. The construction cost estimates are based on the assumptions applied in the EPS Study. The construction costs, excluding land acquisition, are estimated at \$154,000 per unit.
2. Projected Market Rents
 - a. One-bedroom unit: \$2,100 per month;
 - b. Two-bedroom unit: \$2,700 per month; and
 - c. Three-bedroom unit: \$3,000 per month.
3. Affordable Rent Inclusionary Housing Units
 - a. The affordable rents are based on the calculation methodology identified in the City's Housing Element.
 - b. The 2009 low income rents are:
 - i. One-bedroom unit: \$1,441 per month;
 - ii. Two-bedroom unit: \$1,802 per month; and
 - iii. Three-bedroom unit: \$2,065 per month.
4. The threshold stabilized return on total investment for the rental housing projects is set at 6.6%. This return rate is approximately equal to the rate applied in the EPS Study.

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FINANCIAL CONSTRAINTS ANALYSIS

Ownership: Moderate Income Inclusionary

The primary financial impact created by imposing affordable housing requirements on ownership units is the difference between the achievable market rate prices and the allowable prices for the income restricted units. However, there are also some minor differences in cost categories that are driven by the revenues generated by an ownership project. The pro forma analyses in Appendices B and C illustrate the estimated impact created by providing the inclusionary units within a market rate project.

The pro forma analyses results indicate that the requirement to set aside 15% of the units for moderate income households acts to reduce the supportable land value in the near term by 50% (Appendix C – Table 3). A land value reduction in this range can be considered an onerous burden that will act as a constraint to residential development.

Rental: Low Income Inclusionary

To mitigate the financial burden, the proposed Inclusionary Housing Program provides the option for developers to fulfill the requirements by constructing affordable rental units. This section of the analysis evaluates the financial impact associated with providing the required inclusionary units in rental projects.

The financial impact associated with imposing income and affordability restrictions on apartment development is largely related to the decrease in supportable investment created by the reduction in the achievable rents. However, the revenue reduction is offset to some degree by the fact that the property taxes for the income restricted project will be lower than the property taxes for a market rate project. The pro forma analyses in Appendices D and E illustrate the impact created by providing low income rental units.

The results of the comparative pro forma analysis indicate that the proposed inclusionary requirements act to decrease the supportable land value by 10% (Appendix E) This value decrease falls well within the typical range for an inclusionary housing ordinance.

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Development Constraints Conclusions

The results of the ownership residential analysis indicate that the identified inclusionary housing requirements impose an onerous burden on developers. However, the option for developers to fulfill the requirements by providing affordable rental units mitigates the detriment sufficiently to eliminate the constraint to residential development. Thus, it can be concluded that the inclusionary housing requirements do not create an unreasonable constraint on ownership residential development.

ORDINANCE COMPARISON

The financial analyses undertaken by KMA indicate that the inclusionary housing requirements can be fulfilled without creating an unreasonable constraint on residential development. To crosscheck this finding, KMA surveyed over 100 jurisdictions in California that currently impose inclusionary housing requirements. The results of this survey indicate that the identified requirements fall within the norm of the standards imposed by inclusionary housing programs being implemented throughout the state.

The courts have held that affordable housing is a "public benefit", and that locally imposed inclusionary housing ordinances are a legitimate means of providing this public benefit. The courts have further found that the requirements cannot deprive an owner of "*all economically beneficial use*" of the property. However, to date, no definition of all economically beneficial use has been provided. For reference purposes, it should be noted that inclusionary housing programs recently adopted in several California locations have been projected to generate land value reductions in the 30% range.

As discussed previously in this analysis, the inclusionary housing obligations being tested are projected to create a financial detriment that is significantly less than a 30% decrease to the supportable land value. As such, it can be concluded that the proposed inclusionary housing requirements do not create an unreasonable constraint on residential development.

SUPPORTABLE IN-LIEU FEE

To increase the Program's flexibility, the inclusionary housing obligations can be fulfilled through the payment of an in-lieu fee. To establish a recommended in-lieu fee amount, KMA translated the financial impact generated by the inclusionary requirements into a per unit fee. Since it has been determined that the identified inclusionary housing requirements are supportable, this methodology implicitly results in a reasonable in-lieu fee.

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The KMA analysis is based on the assumption that the City will provide developers with the option to fulfill the inclusionary requirements with either ownership or rental units. The analysis further indicates that the provision of affordable rental units generates a substantially smaller financial impact than the provision of affordable ownership units. Thus, the in-lieu fee analysis is based on a rental housing scenario.

The following methodology was used to establish the recommended in-lieu fee amount:

1. As shown on Appendix E – Table 3, the financial impact is estimated at \$591,000 for the 36-unit prototype apartment project being evaluated.
2. The inclusionary housing obligation is applicable to market rate ownership housing development. As such, the in-lieu fee analysis is based on the inclusionary requirement for the 32-unit prototype ownership that was tested previously in this analysis:
 - a. The 32-unit ownership project generates a requirement for five income restricted units.
 - b. When the \$591,000 gap is divided by the five affordable units, the supportable in-lieu fee equals approximately \$118,200 per affordable unit.
3. The affordability gap can also be divided by the total number of market rate ownership units to arrive at a supportable in-lieu fee per market rate unit. Based on the results of the KMA analysis, the supportable in-lieu fee is equal to \$18,500 per market rate ownership unit ($\$591,000 / 32$ units).

CONCLUSIONS

Based on the results of the financial analysis, KMA reached the following conclusions:

1. The Inclusionary Housing Program structure evaluated by KMA does not deprive an owner of “*all economically beneficial use*” of the property, nor does it create an unreasonable constraint on residential development as defined by State Housing Element requirements.
2. The inclusionary option selected by developers will vary depending on the actual scope of development being proposed. However, the financial analysis demonstrates that there is a strong financial incentive for developers to select the in-lieu fee option. Nonetheless, it is possible that some developers may find it preferable to fulfill the inclusionary housing requirements by constructing affordable rental units.

TABLE 1

**AFFORDABLE HOUSING CASE STUDIES
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA**

I. OWNERSHIP - SITE 87,120 SF		
	MARKET RATE SCENARIO	OWNERSHIP: MODERATE INCOME INCLUSIONARY
Number of Units	32	32
Density (Units/Acre)	16.0	16.0
Affordable Housing Requirements	None	5 Units - 15% Moderate Income
Affordable Housing Cost	N.A.	Housing Element Standards
Land Cost ¹	\$167 /SF	\$167 /SF
Supportable Land Value		\$84 /SF
% (Decrease)/Increase in Land Value		-50%

II. RENTAL - SITE 87,120 SF		
	MARKET RATE SCENARIO	RENTAL: LOW INCOME INCLUSIONARY
Number of Units	36	36
Density (Units/Acre)	18.0	18.0
Affordable Housing	None	5 Low Income Units ³
Affordable Housing Cost	N.A.	Housing Element Standards
Land Cost ²	\$68 /SF	\$68 /SF
Supportable Land Value		\$61 /SF
% (Decrease)/Increase in Land Value		-10%

III. Supportable In-Lieu Fee / Market Rate Unit ⁴	\$18,500 /Unit
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¹ The land cost is based on the residual land value supported by the market rate scenario.

² The land cost is set at \$69/ SF based on the EPS Inclusionary Housing Study, 10/7/2008.

³ Based on the number of inclusionary units required by the ownership residential project.

⁴ The in-lieu fee is based on the affordability gap associated with fulfilling the obligation with rental units. See APPENDIX E.

APPENDIX A
AFFORDABLE HOUSING COST CALCULATIONS

APPENDIX A - TABLE 1

AFFORDABLE HOUSING COST CALCULATIONS
OWNERSHIP UNITS
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA

I. Income Assumptions

Income Level	Moderate
Number of Bedrooms	Three-Bedrooms
Benchmark Household Size	Six Person
Household Income for Calculation Purposes ¹	\$119,850

II. Affordable Housing Price Calculation

Household Income	\$119,850
Multiplier ²	3.0
Total Affordable Housing Price	\$359,600

1

Based on the 2009 area median income published by the California Housing & Community Development Department. The household size is set at the number of bedrooms in the unit multiplied times two.

² Based on the methodology defined in the City's Housing Element.

43

APPENDIX A - TABLE 2

**AFFORDABLE HOUSING COST CALCULATIONS
RENTAL UNITS
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA**

I. Income Level	Low
II. <u>One-Bedroom Units</u>	
Benchmark Household Size	Two Person
Household Income for Calculation Purposes ¹	\$59,500
% of Income Allotted to Housing Costs	<u>30%</u>
Annual Income Available for Housing Costs	\$17,850
Monthly Income Available for Housing Costs	\$1,488
Less: Utilities Allowance	<u>47</u>
Total Affordable Rent	\$1,441
III. <u>Two-Bedroom Units</u>	
Benchmark Household Size	Four Person
Household Income for Calculation Purposes ¹	\$74,400
% of Income Allotted to Housing Costs	<u>30%</u>
Annual Income Available for Housing Costs	\$22,320
Monthly Income Available for Housing Costs	\$1,860
Less: Utilities Allowance	<u>58</u>
Total Affordable Rent	\$1,802
IV. <u>Three-Bedroom Units</u>	
Benchmark Household Size	Six Person
Household Income for Calculation Purposes ¹	\$86,300
% of Income Allotted to Housing Costs	<u>30%</u>
Annual Income Available for Housing Costs	\$25,890
Monthly Income Available for Housing Costs	\$2,158
Less: Utilities Allowance	<u>93</u>
Total Affordable Rent	\$2,065

¹

Based on the 2009 household incomes published by the California Housing & Community Development Department. The household size is set at the number of bedrooms in the unit multiplied times two.

APPENDIX B

OWNERSHIP: BASELINE - MARKET RATE PROJECT: 32 UNITS (16 UNITS/ACRE)

APPENDIX B - TABLE 1

ESTIMATED CONSTRUCTION COSTS

OWNERSHIP: BASELINE - MARKET RATE PROJECT: 32 UNITS (16 UNITS/ACRE)

AFFORDABLE HOUSING CASE STUDIES

INCLUSIONARY HOUSING ANALYSIS

NEWPORT BEACH, CALIFORNIA

I. <u>Direct Costs</u>			
Site Work Costs	87,120 Sf Land Area	\$40.00 /Sf Land Area	\$3,485,000
Building Costs ¹	67,952 /Sf GBA	\$285 /Sf GBA	19,366,000
Total Direct Costs			\$22,851,000
II. <u>Indirect Costs</u>			
General Indirect Costs ²	13% Direct Costs		\$2,971,000
Permits & Fees	32 Units	\$20,000 /Unit	640,000
Insurance	32 Units	\$15,000 /Unit	480,000
Developer Fee	3% Sales Revenues		1,769,000
Total Indirect Costs			\$5,860,000
III. <u>Financing/Closing Costs</u>			
Interest During Construction/Absorption ³			\$5,885,000
Loan Origination Fees ⁴	\$35,380,000 Loan Amount	2.5 Points	885,000
Closing & Sales; & Warranties ⁵			3,108,000
Total Financing/Closing Costs			\$9,878,000
IV. <u>Total Construction Costs</u>	32 Units	\$1,206,000 /Unit	\$38,589,000

¹ Average unit size equal to 2,124 square feet. GBA includes a 0% allowance for non-livable area.

² Includes architecture, engineering & consulting; taxes, legal & accounting; marketing; and soft cost contingency.

³ Construction and absorption period interest set at a 10.2% blended return on debt and equity. Carrying costs are based on an 18 month development period. Absorption rate is set at 4 units/month.

⁴ Based on a 60% loan to value ratio.

⁵ Based on 5% of sales revenues plus \$5,000/unit for warranties costs.

APPENDIX B - TABLE 2

PROJECTED SALES REVENUES

OWNERSHIP: BASELINE - MARKET RATE PROJECT: 32 UNITS (16 UNITS/ACRE)

AFFORDABLE HOUSING CASE STUDIES

INCLUSIONARY HOUSING ANALYSIS

NEWPORT BEACH, CALIFORNIA

MARKET RATE SCENARIO ¹

I.	Total Sales Revenues	32 Units @	\$1,842,700 /Unit	\$58,966,000
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¹ Sales price at \$868/sf of net livable area.

APPENDIX B - TABLE 3

RESIDUAL LAND VALUE ANALYSIS

OWNERSHIP: BASELINE - MARKET RATE PROJECT: 32 UNITS (16 UNITS/ACRE)

AFFORDABLE HOUSING CASE STUDIES

INCLUSIONARY HOUSING ANALYSIS

NEWPORT BEACH, CALIFORNIA

I.	Total Sales Revenues	See APPENDIX B - TABLE 2	\$58,966,000				
II.	<u>Project Costs</u>						
	Total Construction Costs	See APPENDIX B - TABLE 1	\$38,589,000				
	Threshold Developer Profit	15% of Total Construction Costs	<u>5,788,000</u>				
	Total Project Costs		\$44,377,000				
III.	<table border="1"><tr><td>Residual Land Value</td><td>87,120 Sf Land Area</td><td>\$167 /Sf Land Area</td><td>\$14,589,000</td></tr></table>	Residual Land Value	87,120 Sf Land Area	\$167 /Sf Land Area	\$14,589,000		
Residual Land Value	87,120 Sf Land Area	\$167 /Sf Land Area	\$14,589,000				

APPENDIX C

OWNERSHIP: IMODERATE INCOME INCLUSIONARY: 32 UNITS (16 UNITS/ACRE)

APPENDIX C - TABLE 1

ESTIMATED CONSTRUCTION COSTS
OWNERSHIP: IMODERATE INCOME INCLUSIONARY: 32 UNITS (16 UNITS/ACRE)
AFFORDABLE HOUSING CASE STUDIES
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA

I. Direct Costs				
Site Work Costs	87,120	Sf Land Area	\$40.00 /Sf Land Area	\$3,485,000
Building Costs ¹	67,952	/Sf GBA	\$285 /Sf GBA	19,366,000
Total Direct Costs				\$22,851,000
II. Indirect Costs				
General Indirect Costs ²	13%	Direct Costs		\$2,971,000
Permits & Fees	32	Units	\$20,000 /Unit	640,000
Insurance	32	Units	\$15,000 /Unit	480,000
Developer Fee ³				1,769,000
Total Indirect Costs				\$5,860,000
III. Financing/Closing Costs				
Interest During Construction/Absorption ⁴				\$6,073,000
Loan Origination Fees ⁵	\$35,380,000	Loan Amount	2.5 Points	885,000
Closing & Sales; & Warranties ⁶				2,738,000
Total Financing/Closing Costs				\$9,696,000
IV. Total Construction Costs	32	Units	\$1,200,000 /Unit	\$38,407,000

¹ Average unit size equal to 2,124 square feet. GBA includes a 0% allowance for non-livable area.

² Includes architecture, engineering & consulting; taxes, legal & accounting; marketing; and soft cost contingency.

³ See APPENDIX B - TABLE 2 - The Developer Fee is set equal to the amount calculated in the market rate scenario.

⁴ Construction and absorption period interest set at a 10.2% blended return on debt and equity. Carrying costs are based on an 18 month development period. Absorption rate is set at 4 units/month.

⁵ Based on a 60% loan to value ratio.

⁶ Based on 5% of sales revenues plus \$5,000/unit for warranties costs.

APPENDIX C - TABLE 2

PROJECTED SALES REVENUES

OWNERSHIP: IMODERATE INCOME INCLUSIONARY: 32 UNITS (16 UNITS/ACRE)

AFFORDABLE HOUSING CASE STUDIES

INCLUSIONARY HOUSING ANALYSIS

NEWPORT BEACH, CALIFORNIA

I.	Market Rate Units ¹	27 Units @	\$1,842,700 /Unit	\$49,752,900
II.	Moderate Income Units - 3 Bd ²	5 Units @	\$359,600 /Unit	<u>1,798,000</u>
III.	Total Sales Revenues			\$51,550,900

¹ Sales price at \$868/sf of net livable area for Three-Bedrooms and \$0/sf of net livable area for Five-Bedrooms.

² See APPENDIX A - TABLE 1 for the affordable housing cost calculations.

APPENDIX C - TABLE 3

**LAND VALUE IMPACT ANALYSIS
 OWNERSHIP: IMODERATE INCOME INCLUSIONARY: 32 UNITS (16 UNITS/ACRE)
 AFFORDABLE HOUSING CASE STUDIES
 INCLUSIONARY HOUSING ANALYSIS
 NEWPORT BEACH, CALIFORNIA**

I. Total Sales Revenues	See APPENDIX C - TABLE 2		\$51,550,900
II. <u>Project Costs</u>			
Total Construction Costs	See APPENDIX C - TABLE 1	38,407,000	
Land Cost ¹	See APPENDIX B - TABLE 3	14,589,000	
Threshold Profit ²	See APPENDIX B - TABLE 3	5,788,000	
			<hr/>
Total Project Costs			\$58,784,000
III. Affordability Gap			(\$7,233,000)
IV. <u>Effective Land Value</u>			
Land Cost		\$14,589,000	
Affordability Gap		(7,233,000)	
			<hr/>
Effective Land Value	87,120 Sf Land Area	\$84 /Sf Land Area	\$7,356,000
% Land Value Decrease			-50%
V. <u>Supportable In-Lieu Fee</u>			
Total Fee		\$7,233,000	
Fee/ Affordable Unit		\$1,446,600 /Unit	
Fee/ Market Rate Unit		\$267,900 /Unit	

¹ Land Cost is based on the Residual Land Value generated by the market rate scenario in APPENDIX B.

² Threshold Profit is based on the amount of profit generated by the market rate scenario in APPENDIX B.

APPENDIX D

RENTAL: BASELINE - MARKET RATE PROJECT: 36 APARTMENT UNITS (18 UNITS/ACRE)

APPENDIX D - TABLE 1

ESTIMATED CONSTRUCTION COSTS
RENTAL: BASELINE - MARKET RATE PROJECT: 36 APARTMENT UNITS (18 UNITS/ACRE)
AFFORDABLE HOUSING CASE STUDIES
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA

II. <u>Direct Costs</u> ¹			
One-Bedroom	14 Units	\$88,450 /Unit	\$1,238,000
Two-Bedrooms	14 Units	\$128,100 /Unit	1,793,000
Three-Bedrooms	8 Units	\$152,500 /Unit	<u>1,220,000</u>
Total Direct Costs			\$4,251,000
III. Indirect & Financing Costs		30% Direct Costs	\$1,275,000
<hr/>			
V. Total Construction Costs	36 Units	\$153,500 /Unit	\$5,526,000

¹ Direct Costs are based on Economic & Planning Systems' Construction Costs from "Inclusionary Housing In-Lieu Fee Study", dated October 7, 2008.

APPENDIX D - TABLE 2

STABILIZED NET OPERATING INCOME
 RENTAL: BASELINE - MARKET RATE PROJECT: 36 APARTMENT UNITS (18 UNITS/ACRE)
 AFFORDABLE HOUSING CASE STUDIES
 INCLUSIONARY HOUSING ANALYSIS
 NEWPORT BEACH, CALIFORNIA

I. <u>Rent Income</u> ¹			
One-Bedroom	14 Units @	\$2,100 /Month	\$352,800
Two-Bedrooms	14 Units @	\$2,700 /Month	453,600
Three-Bedrooms	8 Units @	\$3,000 /Month	<u>288,000</u>
Gross Income			\$1,094,400
Vacancy & Collection Allowance	5% Gross Income		<u>(54,700)</u>
Effective Gross Income			\$1,039,700
II. <u>Operating Expenses</u>			
General Operating Expenses	36 Units @	\$4,200 /Unit	\$151,200
Property Taxes ²	36 Units @	\$3,680 /Unit	<u>132,500</u>
Total Operating Expenses	36 Units @	(\$7,880) /Unit	(\$283,700)
III. <u>Net Operating Income</u>			<u>\$756,000</u>

¹ Market rent = \$2.83/sf for One-Bedroom; \$2.53/sf for Two-Bedrooms; and \$2.44/sf for Three-Bedrooms.

² Based on the project value at a 6.0% capitalization rate and a 1.05% tax rate.

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APPENDIX D - TABLE 3

RESIDUAL LAND VALUE ANALYSIS
STABILIZED NET OPERATING INCOME
RENTAL: BASELINE - MARKET RATE PROJECT: 36 APARTMENT UNITS (18 UNITS/ACRE)
AFFORDABLE HOUSING CASE STUDIES
INCLUSIONARY HOUSING ANALYSIS

I. <u>Warranted Private Investment</u>			
Net Operating Income	See APPENDIX D - TABLE 2		\$756,000
Threshold Return on Total Investment ¹			6.6%
Total Warranted Investment			\$11,455,000
II. Total Construction Cost			
	See APPENDIX D - TABLE 1		\$5,526,000
III. Residual Land Value			
	87,120 Sf Land Area	\$68 /Sf Land Area	\$5,929,000

¹ Threshold Return on Total Investment is based on a 6.0% capitalization rate and 20% profit as a percentage of construction costs.

APPENDIX E

RENTAL: LOW INCOME INCLUSIONARY : 36 APARTMENT UNITS (18 UNITS/ACRE)

APPENDIX E - TABLE 1

ESTIMATED CONSTRUCTION COSTS

RENTAL: LOW INCOME INCLUSIONARY : 36 APARTMENT UNITS (18 UNITS/ACRE)

AFFORDABLE HOUSING CASE STUDIES

INCLUSIONARY HOUSING ANALYSIS

NEWPORT BEACH, CALIFORNIA

I. Direct Costs ¹

One-Bedroom	14 Units	\$88,450 /Unit	\$1,238,000
Two-Bedrooms	14 Units	\$128,100 /Unit	1,793,000
Three-Bedrooms	8 Units	\$152,500 /Unit	<u>1,220,000</u>

Total Direct Costs \$4,251,000

II. **Indirect & Financing Costs** 30% Direct Costs \$1,275,000

III. **Total Construction Costs** 36 Units \$153,500 /Unit \$5,526,000

APPENDIX E - TABLE 2

STABILIZED NET OPERATING INCOME
RENTAL: LOW INCOME INCLUSIONARY : 36 APARTMENT UNITS (18 UNITS/ACRE)
AFFORDABLE HOUSING CASE STUDIES
INCLUSIONARY HOUSING ANALYSIS
NEWPORT BEACH, CALIFORNIA

I. Rent Income

Market Rent ¹			
One-Bedroom	12 Units @	\$2,100 /Month	\$302,400
Two-Bedrooms	12 Units @	\$2,700 /Month	388,800
Three-Bedrooms	7 Units @	\$3,000 /Month	252,000
Low Income ²			
One-Bedroom	2 Units @	\$1,441 /Month	\$34,600
Two-Bedrooms	2 Units @	\$1,802 /Month	43,200
Three-Bedrooms	1 Unit @	\$2,065 /Month	24,800
Gross Income			\$1,045,800
Vacancy & Collection Allowance	5% Gross Income		(52,300)
Effective Gross Income			\$993,500

II. Operating Expenses

General Operating Expenses	36 Units @	\$4,200 /Unit	\$151,200
Property Taxes ³	36 Units @	\$3,480 /Unit	125,300
Total Operating Expenses			(\$276,500)

III. <u>Net Operating Income</u>			\$717,000
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¹ Market rent = \$2.83/sf for One-Bedroom; \$2.53/sf for Two-Bedrooms; and \$2.44/sf for Three-Bedrooms.

² See APPENDIX A - TABLE 2 for the affordable housing cost calculations.

³ Based on the project value at a 6.0% capitalization rate and a 1.1% tax rate.

APPENDIX E - TABLE 3

LAND VALUE IMPACT ANALYSIS
 RENTAL: LOW INCOME INCLUSIONARY : 36 APARTMENT UNITS (18 UNITS/ACRE)
 AFFORDABLE HOUSING CASE STUDIES
 INCLUSIONARY HOUSING ANALYSIS
 NEWPORT BEACH, CALIFORNIA

I. <u>Warranted Private Investment</u>			
Net Operating Income		See APPENDIX E - TABLE 2	\$717,000
Threshold Return on Total Investment ¹			6.60%
Total Warranted Investment			\$10,864,000
II. Total Construction Cost			
		See APPENDIX E - TABLE 1	\$5,526,000
III. Residual Land Value			
			\$5,338,000
IV. <u>Effective Land Value</u>			
Land Cost From Mkt Scenario		See APPENDIX D - TABLE 3	\$5,929,000
Supportable Land Value	87,120	Sf Land Area \$61 /Sf Land Area	\$5,338,000
Decrease in Land Value			\$591,000
% Land Value Decrease			10%
V. <u>Supportable In-Lieu Fee</u>			
Total Fee			\$591,000
Fee/ Affordable Unit			\$118,200 /Unit
Fee/ Market Rate Unit in the Market Rate Ownership Project ²			\$18,500 /Unit

¹ Threshold Return on Total Investment is based on a 6.0% capitalization rate and 20% profit as a percentage of construction costs.

² The Market Rate Ownership Project includes 32 units.

Attachment No. CC 4

Estimated Future RHNA Goals



Estimated Future RHNA Goals

Background (2006 Analysis)

Prior to the 2006 General Plan Update, Housing Program 2.2.1 of the City's Housing Element required that an average of 20 percent of the units in a new residential development be affordable to persons of very low-, low-, or moderate-income, or that an equivalent in-lieu fee be paid. During the preparation of the 2006 General Plan Update, the Planning Commission requested that staff estimate the City RHNA goals over the 25-year horizon of the General Plan Land Use Element (estimated at 2,842 affordable units), and relate the 25-year RHNA goal to a percent of the new residential units included in the draft Land Use Element (15,000 units). The analysis illustrated that to achieve the estimated 25-year RHNA goal, 19 percent of the total units would have to be affordable; however, it was acknowledged at the time that this analysis used highly speculative assumptions as the basis for projecting future RHNA goals. It was also acknowledged that it is unrealistic to assume that the theoretical build-out capacity of 15,000 units would be realized. An alternative analysis was prepared using a realistic development scenario of 7,129 new units (Table 3). Using this figure, it was estimated that as many as 40 percent of the units would have to be affordable to meet our estimated RHNA goals over the 25-year horizon. Although the analysis at the time indicated that the 20 percent inclusionary requirement was reasonable, to strike a proper balance between promoting affordable housing construction and not impeding market rate housing construction, Housing Program 2.2.1 was revised reducing the inclusionary requirement to 15 percent. Included in deliberations as to the appropriate inclusionary requirement was the fact that Housing Program, 2.2.1 was only one component of an overall strategy for meeting RHNA goals.

Revised 2010 Analysis

Since 2006, the City has received new RHNA goals for the 2006-2014 planning period that are substantially higher than what was previously anticipated. Also, the number of new housing units that was ultimately approved in the 2006 General Plan Update was less than what was originally proposed. Therefore, staff has updated the 2006 analysis by revising the estimated RHNA goals for the remaining 21 years of the General Plan horizon (using current and past RHNA goals) and relating that goal to the current realistic development yield. The results of the updated analysis illustrate that to achieve the revised RHNA goal (2,212 affordable units), 47 percent of the total realistic development yield (4,675 units) would have to be affordable.

Calculations

The analysis relies on the assumption that the City's future RHNA and income distributions will remain similar to the combined 2000-2005 and 2006-2014 planning periods. The following tables provide the calculations for the estimated RHNA goals over the General Plan horizon, realistic development yields, and affordable percentages.

Table 1 - Actual RHNA Goals						
RHNA Period	Very Low	Low	Moderate	Above Moderate	Total	Affordable Percent
2006-2014 (includes Newport Coast)	389	319	359	702	1769	60%
2000-2005						
Newport Beach	86	53	83	254	476	
Newport Coast	95	0	0	850	945	
Total	181	53	83	1104	1421	22%
Total	570	372	442	1806	3190	43%
Average						41%

Approximately 41% of the total housing need is for very low-, low- and moderate-income households.

Table 2 - Estimated RHNA Goals for 25-Year General Plan Horizon			
2010 Estimate		2006 Estimate	
Combined 13-year RHNA Goal	3190	Total 5-Year RHNA Goal	1,421
	+13		+5
Total 1-year RHNA Goal	245	Total 1-year RHNA Goal	284
	x21		x25
21-Year RHNA Goal	5145	25-Year RHNA Goal	7,105
Affordable Percent	x.41	Affordable Percent	x.40
Estimated Affordable RHNA Goal	2,212	Estimated Affordable RHNA Goal	2,842

Table - 3 Realistic General Plan Buildout Scenarios		
Areas	2010 Analysis	2006 Analysis
Airport Area	2,200	3,300
Banning Ranch	1,375	1,375
Mariner's Mile	300	454
Newport Center	450	600
Newport Coast	250	400
West Newport Mesa	100	1000
Total Likely Units	4,675	7,129

Table 4 - Percent of Units Needed to Achieve the Projected Affordable RHNA Goals	
Formula	Affordable RHNA Goal / Realistic Development Yield = Affordable Percent
2010 Analysis	2,212/4,675= 0.47 (47%)
2006 Analysis	2,842/7,129= 0.40 (40%)

Attachment No. CC 5
HCD Letter

**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
OFFICE OF THE DIRECTOR**

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August 26, 2009

Mr. Stephen D. Madison
Executive Vice President
Building Industry Association
of Central California
1401 F Street, Suite 200
Modesto, CA 95354

Dear Mr. Madison:

Thank you for your recent inquiry regarding inclusionary ordinances. The Department is pleased to provide information on the requirements of State law and its policy. For your information, neither State law nor Department policy requires the adoption of any local inclusionary ordinance in order to secure approval of a jurisdiction's housing element. State law does require incentives for voluntary inclusionary development (State density bonus law), pronounces housing element law neutral relative to enactment of mandatory local inclusionary provisions, and circumscribes the responsibilities of local governments which do enact inclusionary policies. The relevant sections of the Government Code are described below.

Government Code Section 65915-17, State density bonus law, requires local governments to make incentives available to residential developers that voluntarily propose to reserve specified portions of a proposed development for occupancy by low- or moderate-income households, and indicates that local governments are not to undermine implementation of this provision. Every local government is required to adopt an ordinance establishing how it will implement State density bonus law, including setting forth the incentives the local government will provide.

State housing element law requires jurisdictions to plan for their existing and projected housing needs, identify adequate sites to accommodate their share of the regional housing need, and, among other things, analyze local policies, regulations or requirements that have the potential to constrain the development, maintenance or improvement of housing for all income level. The law also requires programs to "assist in the development of adequate housing to meet the needs of low- and moderate-income households".

Many local governments adopt mandatory inclusionary programs as one component of a comprehensive affordable housing strategy and have demonstrated success in increasing the supply of housing affordable to low- and moderate-income households. However, some inclusionary programs may have the potential to negatively impact the overall development of housing. As a result, local governments must analyze mandatory inclusionary policies as potential governmental constraints on housing production when adopting or updating their housing elements, in the same way that other land-use regulations must be evaluated as potential constraints.

For example, local governments must analyze whether inclusionary programs result in cost shifting where the cost of subsidizing the affordable units is underwritten by the purchasers of market-rate units in the form of higher prices. Such increases can be a barrier to some potential homebuyers who already struggle to qualify for a mortgage, and earn too much to qualify for government assistance. Local governments must also analyze their inclusionary policies to evaluate whether sufficient regulatory and financial incentives are offered to facilitate compliance with the requirements.

In addition, it is important to note that the adoption of mandatory inclusionary zoning programs do not address housing element adequate sites requirements to accommodate the regional housing need for lower-income households. Inclusionary programs are not a substitute for designating sufficient sites with appropriate zoning, densities and development standards as required by Government Code Section 65583(c)(1).

Finally, Government Code Section 65589.8 specifies that nothing in housing element law shall be construed to expand or contract the authority of a local government to adopt an ordinance, charter amendment, or policy requiring that any housing development contain a fixed percentage of affordable housing units. It further states that a local government which adopts such a requirement shall permit a developer to satisfy all or a portion of that requirement by constructing rental housing at affordable monthly rents, as determined by the local government.

California has been for many years in the midst of a severe housing crisis; there are simply not enough homes for the number of residents who need them. Continued undersupply of housing threatens the State's economic recovery, its environment, and the quality of life for all residents. Effectively addressing this crisis demands the involvement and cooperation of all levels of government and the private sector. Both the public and private sector must reexamine existing policies, programs and develop new strategies to ensure they operate most effectively and provide an adequate housing supply for all Californians. The Department is committed to working with its public and private sector partners in this effort for the benefit of California's growing population.

If you need additional information, please call me at (916) 445-4775 or Cathy Creswell, Deputy Director, Division of Housing Policy Development, at (916) 323-3177.

Sincerely,



Lynn L. Jacobs
Director

Attachment No. CC 6

BIA Letter



March 12, 2010

via U.S. Mail and Electronic Mail

David R. Hunt, Esq.
City Attorney
City of Newport Beach
3300 Newport Blvd.
Newport Beach, CA 92663



**Building
Industry
Association
of Southern
California**

17744 Sky Park Circle, Suite 170
Irvine, California 92614
949.553.9500
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<http://www.biasc.org>

**Re: Building Industry Association Comments on Proposed
Inclusionary Housing Requirements**

Dear Mr. Hunt,

As the Vice President and General Counsel of the Building Industry Association of Southern California, Inc., I am writing on behalf of its Orange County Chapter ("BIA/OC") to express our concerns with the city's proposed Inclusionary Housing Proposed Ordinance (the "Proposed Ordinance"). Specifically, the Proposed Ordinance may conflict with California law, which is becoming increasingly clear and prohibitive of undue local government impositions on those who develop or redevelop property.

BIA/OC and its members are among the most steadfast supporters of housing availability in general, and are proponents of appropriate measures at both the State and local levels to increase the availability of housing that is affordable to all California residents and to persons at all levels of income. BIA/OC, its members and affiliates actively support legislation and local policies that encourage the provision of housing, or remove or reduce barriers to the construction of affordable housing. On the other hand, BIA/OC strongly opposes policies that unduly inhibit development of affordable housing or that may unlawfully burden its members.

Recent decisions by the California Courts of Appeal have invalidated local inclusionary housing requirements similar to those included in both the Proposed Ordinance and the City's current inclusionary housing policy. Specifically, in light of the appellate court decisions in *Building Industry Ass'n v. City of Patterson* (2009) 171 Cal.App.4th 886, and in *Palmer/Sixth Street Associates v. City of Los Angeles* (2009) 175 Cal.App.4th 1396, it may be appropriate or necessary for the City to both (i) forgo the Proposed Ordinance, and (ii) review and reconsider its current inclusionary housing policy to determine whether the latter is legally valid and compliant with California law, as clarified by the opinions in these cases.

The recent case law on affordable housing makes clear the following key points:

1. A CITY MUST SHOW "INCLUSIONARY HOUSING" EXACTIONS OR FEES TO BE REASONABLY RELATED TO "DELETERIOUS IMPACTS OF NEW DEVELOPMENT" – SIMILAR TO OTHER DEVELOPMENT FEES AND EXACTIONS

Antelope Valley Chapter
Baldy View Chapter
L.A./Ventura Chapter
Orange County Chapter
Riverside County Chapter

In *Building Industry Association et al. v. City of Patterson*, which was decided in March 2009, the Court of Appeal held that the imposition of neither affordable housing mandates nor fees in lieu thereof was legally justified, because the city attempted to make such an imposition without making an evidentiary showing that the mandate or in lieu fee was "reasonably related" to, and did not exceed, offsetting the affordable housing needs *caused by the new development*.

Specifically, in *Patterson*, the unanimous Court of Appeal invalidated the City's affordable housing in lieu fees (which were to be imposed at the rate of nearly \$21,000 per new home). The amount of the in lieu fee was based on the assumption that the city's need for additional affordable housing units (those identified in its regional housing needs analysis) should be met exclusively by saddling new and prospective development – without any showing of exactly how much, if any, of such the societal needs for affordable housing were in fact caused by the new and prospective market-rate residential development (e.g., as opposed to reflecting an existing deficiencies of affordable housing or a deficiency caused by other factors).

In *Patterson*, the developer had a development agreement with the City. In the agreement, the developer had contracted to pay the city its revised, generally-applicable affordable housing in lieu fees (which were not yet known) – provided that the revised fees were "reasonably justified." The Court of Appeal held that this contractual provision necessarily implied that the fees would need to "conform to existing law." The Court also held that "existing law" in California required that the City must justify its affordable housing in lieu fees in conformity with "the legal standards generally applicable to development fees" -- including the "reasonable relationship" requirement as stated in the Mitigation Fee Act (at Government Code section 66001(b)), and as described by the Supreme Court in *San Remo Hotel v. City & County of San Francisco* (2002) 27 Cal.4th 643. Importantly, *San Remo Hotel* reflects the California Supreme Court's most recent discussion of the standard of review that California courts should use when reviewing "legislatively-adopted" development fees of all types (as opposed to ad hoc exactions). In *San Remo Hotel*, the Supreme Court had explained that, even under the most deferential standard of judicial review, a fee "is not 'reasonably justified' ... unless there is a reasonable relationship between the amount of the fee, ... and 'the deleterious public impact of the development.'"

The City of Patterson had amended its housing element and changed its affordable housing policy to an "inclusionary" approach, requiring 15% of new homes be set aside as "affordable" units, or pay in lieu fees. The City provided no evidence, however, to relate its purported need for affordable housing to any particular impacts of new residential development in the City, nor to any identified needs for housing caused by the particular development project. The Court explained:

The evidence presented in this case reveals that the amount of the fee was not calculated based on the cost of City's affordable housing need attributable to the [the development at issue].... Neither was it based on the affordable housing need attributable to the ... [projected future development in the City].

The *Patterson* Court thus rejected the City of Patterson's method for setting the in lieu affordable housing fees because they were not based on any evidence demonstrating the reasonable relationship between the amount of the fee and the costs related to addressing any deleterious impacts on the City's needs for affordable housing *caused by the particular project*, or reasonably attributable to new residential development in general:

The *Patterson* opinion is seemingly the first published California appellate court opinion that directly addresses affordable housing fees or exactions "on the merits" and how they must be calculated and justified. Properly applied to the issues at and in the City of Newport Beach, *Patterson* has several implications for inclusionary housing policies and exactions concerning mandatory set-asides and/or in lieu fees, including the following:

A. Requirements for Dedication or Set-Aside of Affordable Housing Are "Exactions" and Are Subject to Constitutional and Evidentiary Requirements: Prior to the *Patterson* case, no published California appellate decision had squarely addressed what kind of evidentiary justification (if any) is required in order to legally mandate "affordable housing" units or exact in lieu fees from new development. The holding is that affordable housing policies will be treated like other types of development exactions; and thus they must be shown – at a minimum – to be "reasonably related" to the impacts or community needs caused by new development. Although the legal standard applied is generally considered a very deferential standard (the "reasonable relationship" test), unfairly burdening new and prospective development and redevelopment with the burden of addressing a broader need for affordable housing does not meet the legal test.

B. Legal Standards Generally Applicable to Development Fees Apply Even If the Fee Is Not Imposed to Finance "Public" Facilities: The *Patterson* decision holds that non-traditional or quasi-optional fees or mandates imposed on new development, such as "affordable housing in lieu fees," are governed by the legal standards applicable to other types of development fees and mandates for financing public facilities. The trial court had noted that these fees were to be used for *privately-owned* affordable housing, rather than for publicly-owned facilities, but the Court of Appeal held that did not lessen the City's burden to factually justify the exactions.

C. Even "Legislatively-Enacted" Fees – Those Which Are Not Ad Hoc Exactions – Must Have Sufficient Evidentiary Justification: *Patterson* recognized that current case law holds that legislatively-enacted fees of broad application – as distinguished from project-specific (ad hoc) or discretionary exactions – are generally not subject to the relatively "heightened scrutiny" of *Nollan* and *Dolan* (a "rough proportionality" standard). Instead, the Court in *Patterson* explained that even generally applicable "formulaic, legislatively-mandated" fees or exactions (like an affordable housing ordinance) must be supported by evidence and analysis demonstrating a "reasonable relationship" to an adverse public impact or resulting cost that is shown to be caused by new development. *Patterson* quoted the Supreme Court's *San Remo Hotel* decision: "As a matter of both statutory and constitutional law, such fees must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development."

D. *Patterson* Calls Into Questions the Earlier *Napa* Opinion – and Other Assumptions About Affordable Housing Exactions: The Court of Appeal in *Patterson* expressly questioned the continuing relevance of the one older case that had rejected a challenge to a city's inclusionary ordinance -- *HBANC v. City of Napa* (2001). That case was dismissed at an early stage (on the pleadings), without a careful review of the merits of the ordinance, because the court held that a "facial" challenge to the ordinance was not "ripe." Although unnecessary to the court's decision, the *Napa* court's opinion also included some observations that were complimentary of policies reasonably aimed at promoting "affordable housing," which were viewed by some as a broad endorsement for the "inclusionary zoning" or "inclusionary housing" approach.

The 2001 *Napa* opinion had been viewed by some advocates of mandatory, privately-subsidized affordable housing as "validating" inclusionary programs on their merits, despite the narrow procedural basis of the decision. The *Patterson* opinion, however, in contrast to the *Napa* opinion, involved a careful review of the evidence concerning the City of Patterson's affordability mandate and in lieu fee option, and held that such mandates and fees must be based on an evidentiary showing that new development causes a need for additional affordable housing in a community. Importantly, the Court in *Patterson* noted that *Napa* "was decided about 9 months before the Supreme Court decided *San Remo Hotel*" – implying that the *Napa* opinion is suspect because it was issued without the benefit of the California Supreme Court's reasoning concerning the "reasonable relationship" standard.

E. "Affordable Housing" Exactions Require a "Nexus" -- *Patterson* also requires that local governments demonstrate a reasonable nexus between new market-rate development and the imposition of mandatory affordable housing set-asides or fees in lieu thereof. Following *Patterson*, such mandatory set-asides or in lieu fees must be justified by evidence demonstrating a reasonable relationship between development and affordable housing needs, rather than on the basis of arbitrarily selected set-aside percentages, or needs assessed with a view to the community as a whole. As a consequence, many legal commentators and attorneys have concluded that inclusionary zoning programs need to be reviewed, re-assessed and substantially changed.

There are, however, great difficulties inherent in demonstrating any "reasonable relationship" or nexus between (i) any approval of market-rate housing development or redevelopment, and (ii) the need for more affordable housing. More thoughtful commentators have long been understood and appreciated the illogic of inclusionary zoning. (See, e.g., Ellickson, *The Irony of Inclusionary Zoning* (1981).) The likely significance of the *Patterson* opinion's demand for evidence demonstrating the reasonable relationship was emphasized in a commentary by two prominent land use scholars, published in the State Bar's REAL PROPERTY LAW REPORTER (vol. 32, May 2009):

Prof. Roger Bernhardt: The great issue for me is, how can a city show "the deleterious public impact" on a housing development in terms of creating a need for affordable housing? One can see the linkage between the industrial or commercial development and affordable housing, but where is the nexus when the new development is residential instead?

Prof. David Callies: That's the point: The city can't show a deleterious impact on affordable housing resulting from a residential development. There isn't any. I think these mechanisms won't hold up in court anywhere, and following the *Patterson* decision and the Supreme Court's *Lingle* decision, I don't think they're constitutional in California either.

Similar views have been expressed by public agency attorneys and by legal counsel for proponents of inclusionary housing mandates, regarding the need for cities to reconsider their approach to such housing exactions.

2. THE COSTA-HAWKINS ACT PREEMPTS LOCAL ATTEMPTS TO REGULATE THE INITIAL RENTAL RATES FOR HOUSING THROUGH INCLUSIONARY HOUSING MANDATES

In July 2009, another Court of Appeal opinion held that large portions of the City of Los Angeles' inclusionary housing program were preempted by State law and were invalid – *Palmer/Sixth Street Properties, L.P., et al., v. City of Los Angeles*. Specifically, the *Palmer* court concluded that the city's attempt to impose its inclusionary housing restrictions on the rents to be charged on new housing conflicts with, and is preempted by, the statewide rent control provisions of the Costa-Hawkins Rental Housing Act.

The Costa-Hawkins Act provides in relevant part that all residential landlords have the legal right to "establish the initial rental rate for a dwelling or unit." Civ. Code §1954.53(a). The City of Los Angeles' inclusionary housing ordinance conflicted with the State law; and the fact that its ordinance gave developers the "option" of paying a fee (in lieu of setting aside rent-restricted units) did not save the from invalidation by preemption. The *Palmer* court held that the in lieu fee option was "inextricably intertwined" with the City's preempted affordable housing rental rate requirements. Specifically, the ordinance confronted developers with two supposed "options" – but both options effectively conflicted with State law because neither would allow the developer or owner to establish the initial rental rate for the units.

Importantly, although the *Palmer* opinion focused on inclusionary housing as it relates to rent control, the opinion logically has similar ramifications concerning inclusionary housing mandates aimed at for-sale housing as well. Indeed, there is seemingly no legitimate governmental interest in dictating that newly developed or redeveloped property may not be rented – pursuant to the Costa-Hawkins Act, at market rates – and must instead be sold. Given that, it seems that for-sale inclusionary housing schemes are called into question as well by the *Palmer* opinion.

3. TAKEN TOGETHER, THE PATTERSON AND PALMER OPINIONS INDICATE THE NEED TO REMOVE THE CITY'S PRESENT POLICY AND FORGO THE PROPOSED ORDINANCE

The net result of these two recent appellate court opinions is this: Any requirements imposed on new development or redevelopment to provide some portion or percentage of housing units in a development as "affordable" units to be sold or rented to selected income-restricted

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occupants at below-market terms (or be required to pay fees in lieu of providing such housing units) will be treated like any other "exactions" and must be justified by evidence demonstrating a reasonable relationship between the impacts caused by the new development and the amount of affordable housing or in lieu fees exacted from the development. Therefore, BIA/OC requests that the City of Newport Beach reject the Proposed Ordinance, and consider rescinding its existing policy in light of recent decisions.

BIA/OC and its members look forward to working constructively with the City to provide housing opportunities to all, and to removing barriers to housing supply and affordability. To this end, BIA/OC would welcome additional opportunities to provide input and otherwise help to assure that City ordinances reflect sound and lawful policies.

Thank you for your consideration.

Sincerely,



Andrew R. Henderson
Vice President and General Counsel
Building Industry Association of Southern California, Inc.
on behalf of its Orange County Chapter

cc: City Council Members
David Kiff, City Manager
David Lepo, City Planning Director
Cathy Creswell, Dep. Director, California HCD
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