APPENDIX C

RESIDENTIAL NEXUS STUDY AND INCLUSIONARY HOUSING ANALYSIS:
POLICY RECOMMENDATIONS
MEMORANDUM

To: Connie Chung, Supervising Regional Planner
   Timothy Murphy, Regional Planning Assistant II
   County of Los Angeles

From: Kathleen Head
       Tim Bretz

Date: January 24, 2018

Subject: Residential Nexus Study and Inclusionary Housing Analysis:
          Policy Recommendations

A consulting team comprised of Estolano LeSar Perez Advisors (ELP), Keyser Marston Associates, Inc. (KMA) and LeSar Development Consultants (LDC) was engaged by the County of Los Angeles (County) to prepare an Affordable Housing Action Plan (AHAP) for the County. In accompanying reports, KMA analyzed the following:

1. In the “Residential Nexus Study”, KMA estimated the maximum “Affordable Housing Linkage Fee” amounts that can currently be legally supported under the applicable requirements of the Mitigation Fee Act.

2. In the “Inclusionary Housing Analysis”, KMA evaluated the following:
   a. The Inclusionary Housing production requirements that can currently be imposed on new residential development on a financially feasible basis; and
   b. The in-lieu fee amounts that can be supported on a financially feasible basis. KMA has also used the results of the in-lieu fee analysis to identify the financially feasible Affordable Housing Linkage Fees.
The accompanying reports were prepared to provide foundational support for Affordable Housing Linkage Fee and Inclusionary Housing programs being considered for inclusion in the AHAP. The following memorandum synthesizes the results of the reports in order to provide policy and implementation recommendations.

**OVERVIEW**

**Affordable Housing Production Tools**

It is important to understand that Affordable Housing Linkage Fees and Inclusionary Housing programs can only be expected to fulfill a small piece of a community’s affordable housing needs. The primary tools that are used to provide affordable housing are:

1. The HOME and Community Development Block Grant (CDBG) programs offered by the United States Department of Housing and Urban Development (HUD);

2. The Low-Income Housing Tax Program (Tax Credits) offered under Internal Revenue Code Section 42;

3. State funding sources such as the Affordable Housing and Sustainable Communities (AHSC) Program;

4. Funding provided by the Community Development Commission of the County of Los Angeles; and

5. State and local bond issues targeted to the production of affordable housing and the provision of supportive services.

As Federal and State affordable housing program resources continue to decline, it is important to identify alternative methods for providing affordable housing. Affordable Housing Linkage Fee and Inclusionary Housing programs are two tools that are commonly being used throughout California.
Submarket Analysis

A key parameter that was considered in both the Residential Nexus Study and the Inclusionary Housing Analysis is the diverse mix of physical, demographic and economic conditions exhibited in Los Angeles County. Geographic factors that KMA considered are:

1. The unincorporated areas of Los Angeles County encompass approximately 60% of the total Los Angeles County land area. However, only approximately 4.5% of the land area is zoned for residential development.

2. The unincorporated areas in northern Los Angeles County include large amounts of sparsely populated desert and forest lands. Comparatively, the unincorporated areas in southern Los Angeles County consist of non-contiguous areas that are often referred to as unincorporated urban islands.

3. Each year, HUD and the California Housing and Community Development Department (HCD) establish household income standards to be used in establishing “Affordable Sales Prices” and “Affordable Rents” for each county in California. In contrast, market rate home prices and monthly rents vary widely throughout unincorporated Los Angeles County. This results in a disproportionate disparity between market rate sales prices/monthly rents and Affordable Sales Prices/Affordable Rents.

In recognition of these factors, the Consultant Team and County staff agreed that it would be appropriate to prepare financial feasibility analyses for multiple submarkets. The process of defining the submarkets can be described as follows:

1. The 11 Planning Areas in the General Plan were used as the starting point for defining the submarkets.
2. As the next step, it was determined that the Coastal Islands and Santa Monica Mountains Planning Areas should be excluded from the analysis, because the potential for new residential development is limited in these areas.

3. Then, the boundaries of each of the identified submarkets were drawn to ensure that individual unincorporated areas were fully encapsulated within one submarket, rather than split between multiple submarkets.

4. Based on the results of this evaluation, six submarkets were identified for use in the Residential Nexus Study and the Inclusionary Housing Analysis. A submarket map is presented on the following page, and the submarkets are identified as follows:

   a. Coastal South Los Angeles
   b. South Los Angeles
   c. East Los Angeles/Gateway
   d. San Gabriel Valley
   e. Santa Clarita Valley
   f. Antelope Valley

5. Based on a market survey undertaken by KMA it was determined that there has been an insufficient amount of recent condominium and apartment development in the South Los Angeles submarket, and an insufficient amount of condominium development in the Antelope Valley submarket, to create credible housing prototypes. Therefore, the analyses for the South Los Angeles submarket do not include condominium or rental apartment prototypes, and the submarket analyses for the Antelope Valley do not include condominium prototypes.
Submarket Areas

Antelope Valley
Coastal South Los Angeles
San Gabriel Valley
Santa Clarita Valley
East Los Angeles / Gateway
South Los Angeles

Not a Part of Submarket
Supervisorial District
Unincorporated Areas*

Miles

* Unincorporated areas are a transparent gray and come out as a darker color tone on the map

Source: Department of Regional Planning & KMA, June 2017
Affordable Housing Linkage Fee Programs versus Inclusionary Housing Programs

Both Affordable Housing Linkage Fee and Inclusionary Housing programs have the fundamental objective of adding to the supply of affordable housing. However, the two types of programs approach the affordable housing issue in the following different ways:

1. An Affordable Housing Linkage Fee is directly tied to the increased need for affordable housing that is created by new market rate residential development.

2. An Inclusionary Housing program is targeted to filling a portion of the community’s existing and future unmet need for affordable housing.

The following sections of this memorandum identify the key characteristics of Affordable Housing Linkage Fee and Inclusionary Housing programs. These sections also summarize the results of the Residential Nexus Study and the Inclusionary Housing Analysis.

PROGRAM CHARACTERISTICS

Affordable Housing Linkage Fee Programs

Program Parameters

1. Affordable Housing Linkage Fees provide a funding source to fill the financial gap associated with dedicated affordable housing projects.

2. Affordable Housing Linkage Fees can be imposed on both rental and ownership housing development projects.

3. The legally supportable Affordable Housing Linkage Fee amounts are directly tied to the demand for goods and services created by the residents in new residential development projects.
4. Developers cannot be required to produce affordable housing units under the auspices of an Affordable Housing Linkage Fee program. However, a jurisdiction can allow developers to voluntarily provide affordable housing units in lieu of paying the Affordable Housing Linkage Fee.

5. The revenues generated by an Affordable Housing Linkage Fee program are typically used to assist qualified affordable housing developers in constructing dedicated affordable housing projects:
   a. Affordable housing developers have specific expertise in the development and operation of affordable housing projects; and
   b. Affordable housing developers have experience obtaining and leveraging funding sources, such as Tax Credits, to reduce a project’s financial gap.

Residential Nexus Study Results

1. The Residential Nexus Study established the maximum legally supportable Affordable Housing Linkage Fees in each submarket that was evaluated. However, as a practical matter, the Affordable Housing Linkage Fee should also reflect the financially feasible amounts for the residential product types being developed in the submarkets.

2. The Residential Nexus Study does not include an evaluation of the Affordable Housing Linkage Fees that can be supported on a financially feasible basis. However, the Inclusionary Housing Analysis includes pro forma analyses that were used to establish the in-lieu fee amounts that could be imposed on a financially feasible basis. The results of these in-lieu fee assessments can also be applied to an Affordable Housing Linkage Fee program.

3. In the South Los Angeles and Antelope Valley submarkets, the annual household incomes generated by residents in the new market rate residential development were estimated to average less than $75,000. Given that this falls within the definition of moderate income in Los Angeles County, KMA and the County staff concluded that the household incomes are not high enough to support conducting a nexus study in these two submarkets.
4. The “Feasible Affordable Housing Linkage Fees” are set at the lesser of the amounts that meet the Mitigation Fee Act requirements and the in-lieu fee amounts that were estimated in the Inclusionary Housing Analysis. The results are presented in the following table.

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Single-family Homes</th>
<th>Condos</th>
<th>Rental Apartment Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coastal South Los Angeles</td>
<td>$21.60</td>
<td>$20.00</td>
<td>$6.64</td>
</tr>
<tr>
<td>South Los Angeles</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>East Los Angeles/Gateway</td>
<td>$15.48</td>
<td>$14.41</td>
<td>$6.94</td>
</tr>
<tr>
<td>San Gabriel Valley</td>
<td>$24.30</td>
<td>$18.15</td>
<td>$10.35</td>
</tr>
<tr>
<td>Santa Clarita Valley</td>
<td>$6.17</td>
<td>$4.00</td>
<td>$2.61</td>
</tr>
<tr>
<td>Antelope Valley</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Inclusionary Housing Programs

*Program Parameters*

Inclusionary Housing programs can offer an effective strategy for creating mixed-income housing projects and mitigating economic segregation by dispersing affordable housing throughout the community. The key parameters of Inclusionary Housing programs can be described as follows:

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1 The in-lieu fee amounts are based on the estimates generated under the “Land Value Reduction approach” analysis included in the Inclusionary Housing Analysis. In all but the San Gabriel Valley single-family home scenario, the financially feasible amount was less than the legally supportable amount.
1. Inclusionary Housing programs are focused on the production of affordable housing units within market rate housing projects. Recognizing that Inclusionary Housing programs are intended to reduce the unmet need for affordable housing, it is useful to base the requirements on the need for affordable housing identified by tools such as the Regional Housing Needs Assessment (RHNA) produced by the Southern California Association of Governments (SCAG).

2. As a result of the following court rulings and State legislation, Inclusionary Housing requirements can be imposed on both ownership housing and rental housing:

   a. In 2015, the California Supreme Court ruled that Inclusionary Housing obligations that are imposed on ownership housing developments are land use restrictions that are a valid exercise of a jurisdiction’s zoning powers.²

   b. Rental Housing Development:

      i. In 2009, the California Court of Appeal ruled that affordable housing requirements being imposed by the City of Los Angeles on rental housing development violated the Costa-Hawkins Rental Housing Act.³ That ruling effectively acted to prohibit the imposition of Inclusionary Housing requirements on rental housing developments.

      ii. Assembly Bill (AB) 1505, which is otherwise known as the “Palmer Fix”, was signed into law in September 2017.⁴ This new legislation provides jurisdictions with the ability to adopt ordinances that impose Inclusionary Housing requirements on rental housing developments.

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² California Building Industry Association v. City of San Jose, 61 Cal 4th 435 (San Jose).
³ Palmer/Sixth Street Properties L.P. v. City of Los Angeles, 175 Cal. App. 4th 1396 (Palmer).
⁴ AB 1505 amends California Government Code Section 65850 and adds Section 65850.01.
c. Historically, the courts have determined that the affordable housing requirements imposed by an Inclusionary Housing program cannot deprive property owners of “all economically beneficial use” of their property. However, since the courts have not defined all economically beneficial use, the KMA analysis is based on measurements applied by other California jurisdictions that have implemented Inclusionary Housing programs.

3. Inclusionary Housing programs typically provide developers with alternative options such as:

   a. Modified development standards for the affordable units produced on site within proposed market rate projects;
   
   b. Fulfillment of the affordable housing requirements in an off-site location;
   
   c. Payment of a fee in lieu of producing the required affordable housing units; and
   
   d. Dedication of land that can be used for the development of affordable housing.

**Inclusionary Housing Analysis Results**

**On-Site Production Requirements**

The Inclusionary Housing Analysis identified financially feasible Inclusionary Housing Production requirements based on a series of pro forma analyses of prototype ownership and rental apartment projects in each submarket. The on-site production requirements supported by the KMA pro forma analyses are presented in Table 2. Key assumptions that are included in the analyses are:

1. Condominium analyses were not prepared for the South Los Angeles and Antelope Valley submarkets, and an apartment analysis was not prepared for the South Los Angeles submarket, due to the relative lack of new development of these types currently occurring in these submarkets.
2. Inclusionary Housing programs typically include a project size threshold under which projects are not subject to an on-site production requirement. The threshold project size commonly falls between three and 10 units.

3. The maximum percentages of affordable housing units that can be supported on site within market rate projects are identified for moderate income and lower income scenarios. Only one category can be chosen; the percentages are not additive.

4. Project Characteristics
   a. For ownership housing projects, the scenarios were based on the assumption that the affordable units are comparable to the market rate units in the project.
   b. A wide variety of tools are available to reduce the financial impact associated with the imposition of income and affordability restrictions on rental apartment projects. A commonly used tool is the California Government Code Sections 65915 - 65918 (Section 65915) density bonus:
      i. In the prototype analyses, KMA applied the Section 65915 density bonus, and maximized the bonus percentage by setting aside at least 20% of the base units allowed by zoning for lower income households.
      ii. For reference purposes, KMA translated the results into the percentage of the total units, including the density bonus units, in projects that would be subject to Inclusionary Housing production requirements.
      iii. Moderate income scenarios were not prepared for the rental prototypes, because moderate income rental units do not qualify for a Section 65915 density bonus.
### Table 2:
Financially Feasible On-Site Inclusionary Housing Production Requirements
Percentage of Inclusionary Units

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Moderate Income Scenarios</th>
<th>Lower Income Scenarios</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Coastal South Los Angeles</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>16%</td>
<td>12%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>18%</td>
<td>11%</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>19%</td>
</tr>
<tr>
<td><strong>South Los Angeles</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>19%</td>
<td>9%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>East Los Angeles/Gateway</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>14%</td>
<td>9%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>17%</td>
<td>9%</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>20%</td>
</tr>
<tr>
<td><strong>San Gabriel Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>11%</td>
<td>9%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>24%</td>
</tr>
<tr>
<td><strong>Santa Clarita Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>5%</td>
<td>3%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>16%</td>
</tr>
<tr>
<td><strong>Antelope Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Condominiums</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>24%</td>
</tr>
</tbody>
</table>
In-Lieu Fee Option

The prototype pro forma analyses prepared by KMA include an analysis to determine the in-lieu fee amounts that could potentially be charged by the County. The two scenarios that KMA tested can be described as follows:

1. KMA estimated the in-lieu fees that could be assessed if the land value reduction created by the requirement was limited to 30%.

2. KMA estimated the “Affordability Gap” between the estimated market rate sales prices/rents of the units and the designated affordable sales prices/rents for the Inclusionary Housing units:
   a. For ownership housing projects, 15% of the units were allocated to moderate income households. This set aside was used, because Inclusionary Housing programs often target moderate income households for ownership housing to minimize the financial impacts created by the requirements, and to focus on households that have sufficient discretionary income to devote to the ongoing costs associated with home ownership.
   b. For rental apartment projects, 15% of the units were allocated to lower income households. This allocation methodology was applied to be consistent with the guidelines established by AB 1505. Section 65915 density bonuses were not included in this scenario, because affordable units would not be produced by the developer.

The results of the in-lieu fee analyses are summarized in the following table:5

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5 Condominium analyses were not prepared for the South Los Angeles and Antelope Valley submarkets, and an apartment analysis was not prepared for the South Los Angeles submarket.
## Table 3:
Inclusionary Housing In-Lieu Fee Amounts
Per Square Foot of Building Area

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Land Value Reduction Approach</th>
<th>Affordability Gap Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Coastal South Los Angeles</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$21.60</td>
<td>$28.60</td>
</tr>
<tr>
<td>Condominiums</td>
<td>$20.00</td>
<td>$23.40</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>$6.64</td>
<td>$39.84</td>
</tr>
<tr>
<td><strong>South Los Angeles</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$13.33</td>
<td>$14.70</td>
</tr>
<tr>
<td>Condominiums</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>East Los Angeles/Gateway</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$15.48</td>
<td>$21.80</td>
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<tr>
<td>Condominiums</td>
<td>$14.41</td>
<td>$19.50</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>$6.94</td>
<td>$32.82</td>
</tr>
<tr>
<td><strong>San Gabriel Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$27.27</td>
<td>$54.00</td>
</tr>
<tr>
<td>Condominiums</td>
<td>$18.15</td>
<td>$28.00</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>$10.35</td>
<td>$34.04</td>
</tr>
<tr>
<td><strong>Santa Clarita Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$6.17</td>
<td>$30.00</td>
</tr>
<tr>
<td>Condominiums</td>
<td>$4.00</td>
<td>$14.80</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>$2.61</td>
<td>$24.51</td>
</tr>
<tr>
<td><strong>Antelope Valley</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single-Family Homes</td>
<td>$2.40</td>
<td>$7.70</td>
</tr>
<tr>
<td>Condominiums</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Rental Apartment Projects</td>
<td>$2.13</td>
<td>$15.56</td>
</tr>
</tbody>
</table>
RECOMMENDATIONS

Program Selection

It is a fundamental assumption of the KMA analyses that the County wishes to enact a program that imposes affordable housing obligations on residential development. If that is the case, the first step in the process is to determine whether the obligation should be structured as an Affordable Housing Linkage Fee program supported by the Residential Nexus Study or a production-based program supported by the Inclusionary Housing Analysis. It is not advisable to adopt both types of programs, because that would likely impose an untenable financial burden on residential development.

The primary issues to be considered are:

1. Residential impact fee programs have been used extensively in California. Notably, the majority of programs have been adopted following the Palmer case prohibition on the imposition of Inclusionary Housing requirements on rental housing development, and in response to court challenges to Inclusionary Housing requirements that had been imposed on ownership housing development.

2. Since the County originally identified the tools to be evaluated as part of the AHAP study, the regulatory environment for the imposition of affordable housing requirements on new residential development has changed dramatically. The following changes have validated the imposition of production-based programs:

   a. The findings in the San Jose case established that Inclusionary Housing requirements are land use controls that fall within the purview of a jurisdiction’s zoning powers.

   b. The adoption of AB 1505 cleared the way for jurisdictions to impose Inclusionary Housing requirements on rental housing development.

Now that the legal impediments have been eliminated, it is KMA’s recommendation that the County pursue an Inclusionary Housing program rather than an Affordable Housing Linkage Fee program. The key factors that support this recommendation are as follows:
1. Inclusionary Housing programs can be structured to meet current and future unmet needs for affordable housing without regard for the cause of the shortfall. Comparatively, Affordable Housing Linkage Fees can only be used to mitigate the future need for affordable housing caused by increases in employment generated by the development of market rate housing. Logically, this means that an Inclusionary Housing program is likely to generate more affordable housing units than an Affordable Housing Linkage Fee program.

2. Inclusionary Housing programs can require developers to produce affordable housing units. The only way to obtain affordable housing units under an Affordable Housing Linkage Fee program is if a developer voluntarily offers to produce affordable housing units.

3. The financial impacts created by the imposition of Inclusionary Housing requirements can be mitigated by creating flexible development standards for the affordable units included within market rate projects.

4. Inclusionary Housing programs can offer an option that allows developers to pay a fee in lieu of producing affordable units. Based on the results of the Residential Nexus Study and the Inclusionary Housing Analysis, the in-lieu fee revenues generated by an Inclusionary Housing program could potentially be equal to or greater than the revenue produced by Affordable Housing Linkage Fees.

5. A land donation option can be offered under both Inclusionary Housing programs and Affordable Housing Linkage Fee programs.

**Program Requirements**

If the County chooses to adopt an Inclusionary Housing program, KMA recommends that the following requirements be imposed:

**Ownership Housing Projects**

Inclusionary Housing Production Requirements

KMA recommends that the Inclusionary Housing requirements for ownership housing projects be geared toward moderate income households. This recommendation is made
as a reflection of the fact that moderate income households are likely to have more discretionary income to devote to the ongoing costs associated with home ownership than that of lower income households.

Based on the results of the Inclusionary Housing Analysis, the supportable percentages of on-site moderate income housing production range from 5% to 19% in the six submarkets. However, there is an inconsistent correlation between the market rate home prices exhibited in each submarket and the percentage of affordable housing units that can be supported. Most notably, the magnitude of the Affordability Gaps associated with premium priced homes acts to decrease the percentage of affordable units that can be supported on a financially feasible basis. However, these areas actually exhibit a greater unmet need for affordable housing units than submarkets with lower priced housing inventories.

To resolve this issue, KMA recommends that a 15% requirement be imposed on ownership housing development in each submarket. Recognizing that a 15% requirement cannot be supported in all of the submarkets, KMA recommends that the following options be provided for fulfilling the Inclusionary Housing requirements in ownership housing projects:

1. For on-site development, the comparability of the Inclusionary Housing units to the market rate units should be limited to the exterior improvements and the number of bedrooms provided in the unit. The market rate units should be allowed to be larger in terms of square footage, and to have enhanced interior improvements.

2. Developers should be allowed to fulfill the Inclusionary Housing obligation in an off-site location with either ownership housing units or rental apartment units. This option increases the potential for using the Section 65915 density bonus to reduce the financial impacts created by the Inclusionary Housing requirements.

The following issues should be considered in establishing the covenant periods under which the income and affordability restrictions will be imposed on ownership affordable housing units:

1. The primary factors to consider in reference to long-term irrevocable covenants are:
a. The allowable resale price for an Inclusionary Housing unit is based on the percentage change in the Los Angeles County median income (AMI), mortgage interest rates and other costs associated with home ownership. This severely constrains the opportunity for the home owner to receive appreciation on the resale of the home.

b. The Los Angeles County Assessor will assess the home value based on the Affordable Sales Price. This lowers the home owner’s annual property tax cost.

c. The ongoing administration and monitoring to ensure compliance with the occupancy requirements and resale controls is labor intensive.

2. The factors to be considered for programs that allow the income and affordability restrictions to terminate upon resale of Inclusionary Housing units are:

a. Inclusionary Housing units that can be resold at market rate prices are more easily marketed than units that are subject to long-term covenants.

b. Inclusionary Housing programs that allow for the income and affordability covenants to terminate upon the first resale of the home typically require the home owner to provide the jurisdiction with a defined percentage share of the equity appreciation achieved upon the resale of the home. The Section 65915 density bonus program also applies this approach.

c. Mortgage financing requirements limit the equity appreciation share received by the jurisdiction to the percentage share the Affordability Gap represented of the market rate price when the Inclusionary Housing unit was originally sold. The revenues generated by the equity sharing arrangement are insufficient to replace the affordable unit that was lost from the inventory.6

6 To generate sufficient revenue to replace the Inclusionary Housing unit, the equity appreciation share would need to be set at the percentage the Affordability Gap represented of the original market rate price minus the first trust deed mortgage amount.
d. When Inclusionary Housing requirements and the Section 65915 density bonus are coupled for ownership housing projects, the jurisdiction is required to approve the statutorily established density bonus, but the affordable units are lost from the inventory when they are resold.

e. The Inclusionary Housing units will only need to be monitored until the units are resold for the first time and the covenants are terminated. Thus, the ongoing administration and monitoring functions are less labor intensive than is required for units subject to long-term irrevocable covenants.

Inclusionary Housing Program Options

1. Developers should be provided a by-right option to pay a fee in lieu of producing Inclusionary Housing units for ownership housing projects under the following conditions:

   a. The in-lieu fee payment amount should be set at a sufficient amount to allow the County to subsidize an equivalent number of units in a dedicated affordable housing project.

   b. To estimate the in-lieu fee amount, KMA prepared a prototype rental apartment project that is financed with a combination of Tax-Exempt Multifamily Bonds and the automatically awarded 4% Tax Credits. The results of this analysis indicate that the in-lieu fee should be set at approximately $20 per square foot of the building area developed in the market rate ownership housing project.

2. Developers should be allowed to dedicate developable land to the County if it meets all of the following criteria:

   a. The site has General Plan and zoning designations in place that allow for the development of the required number of Inclusionary Housing units; and

   b. The developer makes a cash contribution that fills the financial gap remaining after the donation of the site at no cost.
Rental Apartment Projects

The Inclusionary Housing Analysis identified support for a lower income requirement ranging from 16% to 24% of the total units within a market rate rental apartment project. However, it is important to consider that AB 1505 imposes the following key limitations on Inclusionary Housing requirements imposed on rental apartment projects:

1. HCD has the authority to review a rental Inclusionary Housing ordinance if it imposes an affordable housing requirement that exceeds 15% percent of the units in the project, and/or the income level is set at a more stringent standard than 80% of the AMI, if at least one of the following conditions apply:
   a. The jurisdiction has not met at least 75% of its RHNA housing need for above-moderate income units.
   b. HCD finds that the jurisdiction has not submitted their housing element report for at least two consecutive years.

2. If the affordable housing requirement is set at more than 15% of the units and/or the income restriction is set at a more restrictive level than 80% of the AMI, HCD can require the jurisdiction to prepare an economic feasibility study to prove that the Inclusionary Housing ordinance does not unduly constrain the production of housing.

3. Jurisdictions are required to provide a variety of options for fulfilling affordable housing obligations that are imposed on rental apartment projects that are subject to an Inclusionary Housing ordinance. AB 1505 identifies the following options, but further indicates that this is not an exhaustive list:
   a. A payment in lieu of producing the required affordable housing units;
   b. Off-site construction of the required number of affordable housing units;
   c. Dedication of land for the subsequent development of the required number of affordable housing units; and
d. Acquisition and rehabilitation of existing market rate residential units, and the subsequent imposition of income and affordability restrictions on some or all of the units.

In recognition of the limitations imposed by AB 1505, KMA recommends that the County structure the Inclusionary Housing requirements for rental apartment projects as follows:

1. The covenant period for Inclusionary Housing units in rental apartment projects should be set at 55 years. This is the covenant period applied by the Section 65915 density bonus program and the Tax Credit program.

2. The preferred option should be for the on-site production of the Inclusionary Housing units. The requirement should be for 15% of the units in the market rate project to be set aside for lower income households:7

   a. The units should be required to be of comparable size and quality to the market rate units; and
   
   b. The units should be dispersed throughout the project.

3. An in-lieu fee option should be provided that is based on the Affordability Gap associated with providing the affordable units on site within the market rate project. These gaps are currently estimated to vary by submarket from $15.56 to $39.84 per square foot of building area in the market rate project.

4. Off-site construction of the required number of Inclusionary Housing units should be allowed under the following conditions:

   a. The development site must be located within ½ mile of the market rate project.
   
   b. The bedroom mix for the off-site project must be comparable to the bedroom mix at the market rate project.

7 For the purposes of obtaining outside financial assistance and/or the use of the Section 65915 density bonus, the developer should have the option to impose stricter income and affordability standards.
c. The project must meet quality standards imposed by the County.

5. Land dedications should be allowed if the following requirements are met:
   a. The site has General Plan and zoning designations in place that allow for the
      development of the requisite number of affordable housing units; and
   b. The developer makes a cash contribution equal to the financial gap exhibited
      by the project after factoring in the donation of the site at no cost.

6. The acquisition and rehabilitation of existing residential projects should only be
   allowed under the following circumstances:
   a. The existing units in the project must have been cited for substantial
      building code violations;
   b. All of the units must have been vacant for at least 90 days;
   c. The direct rehabilitation costs must exceed 25% of the market value of
      the units after the rehabilitation is completed;\(^8\) and
   d. The rents charged for the Inclusionary Housing units that are included in
      the project must be at least 10% less the achievable market rents for the
      units.

**Program Design**

The County should include the following key components in the design of an
Inclusionary Housing program:

1. A phase-in period should be provided to mitigate the impacts experienced by
   developers that purchased properties before the Inclusionary Housing program
   was adopted.

\(^8\) Based on the California Health and Safety Code Section 33413(2)(A)(iv) definition of substantial
rehabilitation.
2. The minimum project size that will trigger the Inclusionary Housing requirements should be identified. For reference purposes, minimum project size requirements commonly fall within the range of three to 10 units.

3. The most successful Inclusionary Housing programs are based on a clear set of administrative procedures. Consistent application of clear guidelines allows developers to factor in the programs’ impacts as part of the due diligence process related to property acquisition:

   a. An administrative procedures manual should be created and updated periodically to reflect changes in economic and demographic characteristics that occur over time.

   b. The Inclusionary Housing program should be updated at regular intervals:

      i. The entire program should be re-evaluated at least every five years.

      ii. To allow in-lieu fees to keep pace with changes in the market place during the intervening periods, the in-lieu fees should be adjusted each year based on a readily accessible and neutral third-party published source.

4. A staffing plan should be created for managing the development process and the ongoing monitoring of the Inclusionary Housing units once they are built.