The Economics of Land Use

Administrative Draft Report

Inclusionary Housing In-Lieu Fee

Prepared for:

Mono County

Prepared by:

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EPS #181044

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1. EXECUTIVE SUMMARY

In advance of the August 30, 2018 expiration of the suspension of the County's Housing Mitigation Ordinance (HMO), Economic & Planning Systems, Inc. (EPS) was retained to review and update the County's affordable housing fees, including the inclusionary housing in-lieu fee. In this report, EPS calculates the in-lieu fee that corresponds to the requirements reflected in the County's HMO based on current market conditions. With the passage of Assembly Bill 1505 in the fall of 2017, Mono County intends to update the HMO and implement an inclusionary requirement and corresponding in-lieu fee for both single-family and multifamily housing. [To be confirmed based on direction from the BOS on 6/19.]

Language in the County's suspended HMO indicates that developers of single-family projects are required to provide one affordable unit for every ten units developed. Put differently, this inclusionary policy translates to providing 10 percent of the units at income-restricted, below-market-rate (BMR) prices. The distribution of affordable units varies by the number of units required (currently Table Y, as referenced in Chapter 15.40 of the Mono County Code). However, based on discussions with County staff, EPS is proposing to simplify the in-lieu fee to reflect the following requirements: of the 10 percent of BMR units, one-half must be available to moderate income households (households earning up to 120 percent of Area Median Income (AMI)), and the remaining half must be offered to low income households (households earning up to 80 percent of AMI).

For multifamily projects, developers must provide one below-market rate unit for every 15 units developed, which translates to a 6.7 percent inclusionary requirement, and the affordable units must be available to low income households (households earning up to 80 percent of AMI).

This report estimates the subsidies that may be required of the County to support affordable housing in the event that developers do not build the units themselves, and presents calculations meant to inform the update of an "in-lieu fee" that may be imposed on both for-sale and rental residential development.

As shown below in **Table 1**, EPS calculates an in-lieu fee for single-family developments of $9,387 per market-rate unit based on the 10 percent inclusionary requirement. Assuming that an average newly constructed single-family market-rate unit in Mono County is 2,000 square feet, this per-unit estimate is equivalent to $4.69 per square foot. **Table 2** shows the in-lieu fee for multifamily developments, which is calculated as $9,362 per market-rate unit (or $4.68 per square foot assuming a 2,000 square foot unit) based on the 6.7 percent inclusionary requirement. In some cases, jurisdictions set the in-lieu fee at a level that is higher than the cost of providing/building the units onsite to encourage developers to provide the units onsite rather than opt to pay the in-lieu fee.

Table 1 Summary of Single-family In-Lieu Fee Calculation, Based on 10% Inclusionary Requirement

Item	Low (80% AMI)	Median (100% AMI)	Moderate (120% AMI)	Total [1]	In-Lieu Fee per Affordable Unit	In-Lieu Fee per Market-Rate Unit
Units	5.0	0.0	5.0	**10**	10	100
Value/Unit	$204,818	$216,909	$296,545			
Total Value	$1,024,091	$0	$1,482,727	$2,506,818		
Costs/Unit	$344,552	$344,552	$344,552			
Total Costs	$1,722,758	$0	$1,722,758	$3,445,515		
Subsidy per Unit	$139,733	$127,642	$48,006			
Total Subsidy Required	$698,667	$0	$240,030	**$938,697**	***$93,870***	***$9,387***

[1] Reflects an inclusionary requirement of one (1) Below Market Rate (BMR) unit for every 10 units developed.

Sources: Mono County; Economic & Planning Systems, Inc.

Table 2 Summary of Multifamily In-Lieu Fee Calculation, Based on 6.7% Inclusionary Requirement

Item	Low (80% AMI)	Total	In-Lieu Fee per Affordable Unit	In-Lieu Fee per Market-Rate Unit
Units	6.7	**6.7**	6.7	100
Value/Unit	$204,818			
Total Value	$1,372,282	$1,372,282		
Costs/Unit	$344,552			
Total Costs	$2,308,495	$2,308,495		
Subsidy per Unit	$139,733			
Total Subsidy Required	$936,213	**$936,213**	***$139,733***	***$9,362***

[1] Reflects an inclusionary requirement of one (1) Below Market Rate (BMR) unit for every 15 units developed.

Sources: Mono County; Economic & Planning Systems, Inc.

2. METHODOLOGY

Language in the County's suspended HMO indicates that developers of single-family projects are required to provide one affordable unit for every ten units developed, or 10 percent of the units are to be offered at income-restricted, BMR prices. In the updated HMO, EPS recommends that of the 10 percent of BMR units, one-half should be available to moderate income households (households earning up to 120 percent of AMI), and the remaining half should be offered to low income households (households earning up to 80 percent of AMI). For multifamily projects, developers must provide one below-market rate unit for every 15 units developed, which translates to a 6.7 percent inclusionary requirement, and the affordable units must be available to low income households (households earning up to 80 percent of AMI).

Through an affordability gap analysis, this report estimates the subsidy needed to produce multifamily rental housing that is affordable to low- and moderate-income households (80 and 120 percent of AMI) in the event that developers do not build the units themselves. Even for single-family developments, it is assumed that the in-lieu fees would be used as a source of subsidy to produce rental housing, because this has been the most common practice of counties and cities in the past. This assumption also tends to yield a more conservative (i.e., low) in-lieu fee than would result if it were assumed that all in-lieu fees were used to construct larger and less dense housing units such as townhomes or single-family detached units.

Maximum Affordable Housing Rents

The maximum rents affordable to low- and moderate-income households are calculated as a factor of the income level of the intended occupants. The income levels are set for the whole of Mono County by the California Department of Housing and Community Development (HCD) on an annual basis. **Table 3** shows the income limits for 2018, which vary by the number of people in the household. The average owner-occupied household in Mono County has 2.38 people, and the average renter-occupied household has 3.26 people. For this reason, EPS has assumed that the average household being served by new affordable housing would house approximately three people. Moreover, the AMI for a family of three in Mono County is $73,100 in 2018, as shown below. Interestingly, the 2018 income limits in Mono County are the same as the 2017 income limits, yet development costs are known to have risen over the past year.

Table 3 2018 Affordable Housing Income Limits for Mono County

Income Group	Income Definition	2018 Maximum Income 3-Person Household
Very Low	>30% to ≤50% AMI	$36,550
Low	>50% to ≤80% AMI	$57,550
Median (Base)	>80% to ≤100% AMI	$73,100
Moderate	>100% AMI to ≤120% AMI	$87,700

Source: Mono County 2018 Income Limits, California Housing and Community Development (HCD).

EPS has assumed a housing cost to income ratio of 30 percent and has used this factor to calculate the annual spending on housing at the low and moderate income levels. Then the annual spending on utilities is subtracted from the annual spending on housing to determine the maximum rent that a household can pay, as summarized on **Table 4** below. A low-income household can pay up to $1,133 on monthly rent, while a moderate-income household can pay $1,887. Further detail on utility allowances for Mono County is available in **Table A-1**.

Table 4 2018 Maximum Supported Rents by Income Category

					Max Rent Assumptions [1]	
Income Category	AMI	Annual HH Income (3-Person)	Annual Spending on Housing [1]	Annual Spending on Utilities [2]	*Annual Rent*	*Monthly Rent*
Very Low	50%	$36,550	$10,965	$3,672	$7,293	$608
Low	80%	$57,550	$17,265	$3,672	$13,593	$1,133
Median	100%	$73,100	$21,930	$3,672	$18,258	$1,522
Moderate	120%	$87,700	$26,310	$3,672	$22,638	$1,887

[1] Assumes a housing costs to income ratio of 30 percent. Includes rent plus utilities.
[2] Assumes annual utility expenditures consistent with the Mono County CDC limits for a 2-bedroom unit (assumes use of electricity for heating and cooking). Utility costs effective January 2018.

Sources: Mono County Community Development Commission; U.S. Department of Housing and Urban Development Utility Allowances (effective January 2018); Economic & Planning Systems, Inc.

Affordability Gap Analysis

Product Type

The analysis assumes that new lower-income households would be housed in affordable units that are efficient to develop, both in terms of density and construction type, thus the calculated fee is the same for single-family and multifamily housing. The assumed prototype reflects multifamily construction at 26 dwelling units to the acre with surface parking.[1] This building prototype is generally cost-effective to construct, as it makes efficient use of land and does not involve overly expensive construction materials or techniques.

California State law (California Health and Safety Code Section 50052.5) assumes that a 2-bedroom unit is occupied by a 3-person household, and this assumption is used in this analysis. Consistent with input from the County, EPS assumes that the typical gross square footage of a 2-bedroom rental unit in the County will be approximately 1,150 square feet. Applying an efficiency ratio of 85 percent to account for shared lobbies, hallways, etc., results in net square footage of 975 square feet.

Development Cost Assumptions

Affordable housing development costs include land costs, direct costs (e.g., labor and materials), and indirect or "soft" costs (e.g., architecture, entitlement, marketing, etc.). For rental projects, operating costs also must be incorporated into the analysis. Data from recent Mono County developments and recent Mono County land transactions have been combined with EPS's information from various market-rate and affordable housing developers to estimate appropriate development cost assumptions for use in Mono County. These assumptions are shown on **Table 5** and indicate that the total development cost per unit for rental apartments is about $344,500, or $300 per square foot.

[1] Based on the Mono County General Plan, which indicates that multifamily residential development projects containing density bonuses may not exceed 26 units/acre.

Table 5 Affordability Gap Analysis -- Rental Product Type

	2-Stories Multifamily Building with Surface Parking			
	Very Low Income (50% AMI)	Low Income (80% AMI)	Median (100% AMI)	Moderate Income (120% AMI)
Development Program Assumptions				
Density/Acre [1]	26	26	26	26
Gross Unit Size	1,147	1,147	1,147	1,147
Net Unit Size [2]	975	975	975	975
Number of Bedrooms	2	2	2	2
Number of Persons per 2-Bedroom Unit [3]	3	3	3	3
Parking Spaces/Unit [4]	2.17	2.17	2.17	2.17
Cost Assumptions				
Land/Acre [5]	$519,000	$519,000	$519,000	$519,000
Land/Unit	$19,962	$19,962	$19,962	$19,962
Direct Costs				
Direct Construction Costs/Net SF [6]	$167	$167	$167	$167
Direct Construction Costs/Unit	$191,000	$191,000	$191,000	$191,000
Parking Construction Costs/Space	$5,000	$5,000	$5,000	$5,000
Parking Construction Costs/Unit	$10,850	$10,850	$10,850	$10,850
Subtotal, Direct Costs/Unit	$201,850	$201,850	$201,850	$201,850
Indirect Costs as a % of Direct Costs [7]	40%	40%	40%	40%
Indirect Costs/Unit	$80,740	$80,740	$80,740	$80,740
Profit Margin (% of all costs)	14%	14%	14%	14%
Profit (rounded)	$42,000	$42,000	$42,000	$42,000
Total Cost/Unit	$344,552	$344,552	$344,552	$344,552
Total Cost/SF	$300	$300	$300	$300
Maximum Supported Home Price				
Household Income [8]	$36,550	$57,550	$73,100	$87,700
Revenue to Property Owner/Year [9]	$10,965	$17,265	$21,930	$26,310
(less) Operating Expenses per Unit/Year [10]	($6,000)	($6,000)	($10,000)	($10,000)
Net Operating Income	$4,965	$11,265	$11,930	$16,310
Capitalization Rate [11]	5.5%	5.5%	5.5%	5.5%
Total Supportable Unit Value [12]	$90,273	$204,818	$216,909	$296,545
Affordability Gap	**($254,279)**	**($139,733)**	**($127,642)**	**($48,006)**

[1] The Mono County General Plan indicates that multifamily residential development projects containing density bonuses may not exceed 26 units/acre (Land Use Element, page II-155).

[2] An efficiency ratio of 85% is applied to the gross unit size to calculate the net unit size.

[3] For this analysis, EPS has assumed an average unit for income-qualified worker households would be 2-bedrooms. State law (Health and Safety Code Section 50052.5) indicates that a 2-bedroom unit should be assumed to be occupied by a 3-person household.

[4] The Mono County General Plan indicates that each residential unit requires two (2) parking spaces, and for every six (6) units, one (1) guest parking space is required (Land Use Element, page II-228).

[5] Land values are based on recently reported CoStar land sale transactions in the County.

[6] Construction cost estimates are based on 2018 Saylor Construction Costs for Zone 3 with a Fresno County index adjustment (Mono County is not available). With Mono County Staff input, the direct costs are rounded up so that total costs per square foot are $300, consistent with what County staff is observing in terms of current construction costs. Assumes construction of a two story apartment, with a 10-foot story height, and 15,000 sq. ft. of gross floor area, with wood siding on stud frame.

[7] Includes costs for architecture and engineering; entitlement and fees; project management; appraisal and market study; marketing, commissions, and general administration; financing and charges; insurance; developer fee and contingency.

[8] Based on 2018 income limits for a three-person household in Mono County.

[9] Assumes housing costs (e.g., rent and utilities) to be 30% of gross household income.

[10] Operating expenses are generally based on data reported by CoStar and reflective of properties in Mono County. Estimates are inclusive of utility costs and property taxes, except Very Low and Low properties which are assumed to be exempt from property taxes.

[11] The capitalization rate is used to determine the current value of a property based on estimated future operating income, and is typically a measure of estimated operating risk. The capitalization rate used in this analysis is based on recent CoStar reported transaction data for a transaction in the County.

[12] The total supportable unit value is determined by dividing the net operating income by the capitalization rate.

Sources: Mono County; California Housing and Community Development; Saylor Construction Cost Estimates (2018); IRR Monitor Investor Survey; CoStar Group; and Economic & Planning Systems, Inc.

Revenue Assumptions

To calculate the values of the affordable units, assumptions must be made regarding the applicable income level (low and moderate) and the percentage of household income spent on housing costs. In addition, translating these assumptions into unit prices and values requires estimates of operating expenses and capitalization rates. The following assumptions were used in these calculations:

- *Income Levels:* This analysis estimates the subsidy required to produce units for households earning up to 80 and 120 percent of AMI for a three-person household. In 2018, AMI in Mono County for these households is $73,100, as shown in the HCD's income limits chart (see **Table 3**).

- *Percentage of Gross Household Income Available for Housing Costs:* HCD standards on overpaying for rent indicate that households should pay no more than 30 percent of their gross income on housing costs. For this analysis, EPS has assumed that all households spend 30 percent of their gross income on housing costs.

- *Operating Costs for Rental Units:* This analysis assumes that apartment operators incur annual operating costs of $6,000 per unit, which include the cost of utilities, for units affordable at 80 percent of AMI or below. EPS has assumed the units for median and moderate-income households would have similar operating costs but would be built by for-profit builders and thus also subject to property taxes, increasing their annual operating cost to $10,000 per unit.

Affordability Gap Results

Table 5 shows the subsidies required for construction of rental apartments for households at low and moderate-income levels. As shown, a unit affordable to a household earning 80 percent of AMI is expected to require a subsidy of roughly $139,700. A household at 120 percent of AMI requires a subsidy of $48,000.

It is worth noting that the affordability gaps estimated in this analysis are not as large as they might be using other also-valid assumptions. For example, the funding gaps for low-income units assume that prices are set at 80 percent of median income, while State law indicates low-income unit prices may be set at 70 percent of median income. This methodology used by EPS yields higher unit values and thus results in lower fees than would result from less conservative assumptions.

In-Lieu Fee Calculations

As shown on **Table 5**, a typical "low" income unit will require a subsidy of roughly $139,700, while a "moderate" income unit will require a subsidy of roughly $48,000. For a theoretical 100-unit single-family housing development, 10 total affordable units would be required, with an aggregate subsidy of $938,700 for those 10 units (see **Table 6**). As shown below, this translates to a weighted average subsidy of roughly $93,900 per affordable unit. If those units are not produced within the project, but rather the County is expected to subsidize their construction elsewhere in the community, the 100 market-rate units in the project would be subject to an in-lieu fee of $9,387 per market-rate unit.

Table 6 In-Lieu Fee Calculation, Based on 10% Inclusionary Requirement

					In-Lieu Fee	
Item	***Low (80% AMI)***	***Median (100% AMI)***	***Moderate (120% AMI)***	***Total [1]***	*per Affordable Unit*	*per Market-Rate Unit*
Units	5.0	0.0	5.0	**10**	10	100
Value/Unit	$204,818	$216,909	$296,545			
Total Value	$1,024,091	$0	$1,482,727	$2,506,818		
Costs/Unit	$344,552	$344,552	$344,552			
Total Costs	$1,722,758	$0	$1,722,758	$3,445,515		
Subsidy per Unit	$139,733	$127,642	$48,006			
Total Subsidy Required	$698,667	$0	$240,030	**$938,697**	***$93,870***	***$9,387***

[1] Reflects an inclusionary requirement of one (1) Below Market Rate (BMR) unit for every 10 units developed.

Sources: Mono County; Economic & Planning Systems, Inc.

While it is useful to think of the total in-lieu fee as it may apply to each market-rate unit, it is also useful to know the fee per affordable unit, as some projects will be required to provide a certain number of units but may meet any fractional obligation through payment of a fee. For example, under the current inclusionary housing ordinance, which requires 10 percent inclusionary units, a 15-unit project would be required to provide 1.5 affordable units. If one unit is provided on site, the additional 0.5-unit requirement could be met by charging a fee of 0.5 times the $93,900 per affordable unit fee, or a total payment of about $47,000.

For a theoretical 100-unit multifamily housing development, 6.7 affordable units would be required, equating to a subsidy of $936,200 (see **Table 7**). Thus, the weighted average subsidy is about $139,700 per affordable unit, and the in-lieu fee is equal to $9,362 per market-rate unit.

Table 7 In-Lieu Fee Calculation, Based on 6.7% Inclusionary Requirement

Item	Low (80% AMI)	Total	In-Lieu Fee per Affordable Unit	In-Lieu Fee per Market-Rate Unit
Units	6.7	**6.7**	6.7	100
Value/Unit	$204,818			
Total Value	$1,372,282	$1,372,282		
Costs/Unit	$344,552			
Total Costs	$2,308,495	$2,308,495		
Subsidy per Unit	$139,733			
Total Subsidy Required	$936,213	**$936,213**	***$139,733***	***$9,362***

[1] Reflects an inclusionary requirement of one (1) Below Market Rate (BMR) unit for every 15 units developed.

Sources: Mono County; Economic & Planning Systems, Inc.

APPENDIX A:

Mono County Utility Allowances

Table A-1 Mono County Utility Allowances per Month, Attached Dwellings

Item	2-Bedroom Apartment
Electricity [1]	$180
Other Allowances	
Other Electric	$22
Water	$26
Sewer	$18
Garbage	$35
Range	$12
Refrigerator	$13
Subtotal, Other Allowances	$126
Total Utility Allowance per Month	**$306**

[1] Assumes use of electricity for space heating, cooling, cooking, and water heating.

Sources: U.S. Department of Housing and Urban Development Utility Allowances (effective January 2018); Economic & Planning Systems, Inc.