Monterey Bay
ECONOMIC PARTNERSHIP

What Realistic Policy Changes Could Improve Housing Affordability in the Monterey Bay Region?

January 2018

Background

This paper focuses on what local policy changes

a) have been thoroughly researched, recommended, and/or tested in other locations for their effect on improving housing affordability in a highly constrained housing market;

b) are far from fully implemented within the Monterey Bay Region;

c) are likely to have a positive effect on affordability within the housing and policy characteristics of Monterey Bay Region; and

d) have been judged by the authors to be, broadly speaking, politically realistic in many of the local jurisdictions within the Monterey Bay Region.

This paper does not describe the housing crisis that the region is currently facing and the negative consequences thereof, which is well documented elsewhere. Nor does it examine the detailed differences between jurisdictions within the region, exactly how best to implement these policies within each jurisdiction, nor what some of the trade-offs to these policies would be. We hope, rather, that this paper can be a starting point for jurisdictions to more fully examine and consider policy changes for improving housing affordability. We also hope that more regional conversation, advocacy, and coordination toward improving affordability can take place.

We would like to continue to update this research, and therefore welcome questions, comments, and ideas. Please feel free to contact Sibley Simon at sibley@envisionhousing.us or Matt Huerta at mhuerta@mbep.biz .

Alterable Drivers of Affordability

It is beyond the scope of this report to fully explain the complex nuances of what makes housing expensive to develop and the housing market unaffordable in our communities. Some drivers of cost are nearly unchangeable (e.g. frequently difficult soil conditions), some are beyond the ability of local jurisdictions to change (e.g. certain over-uses of CEQA lawsuits), and some have near-consensus support for leaving in place (e.g. preserving the region's productive farm land). To evaluate and prioritize housing policy change, though, explicit mention of the realistically improvable affordability drivers is critical.

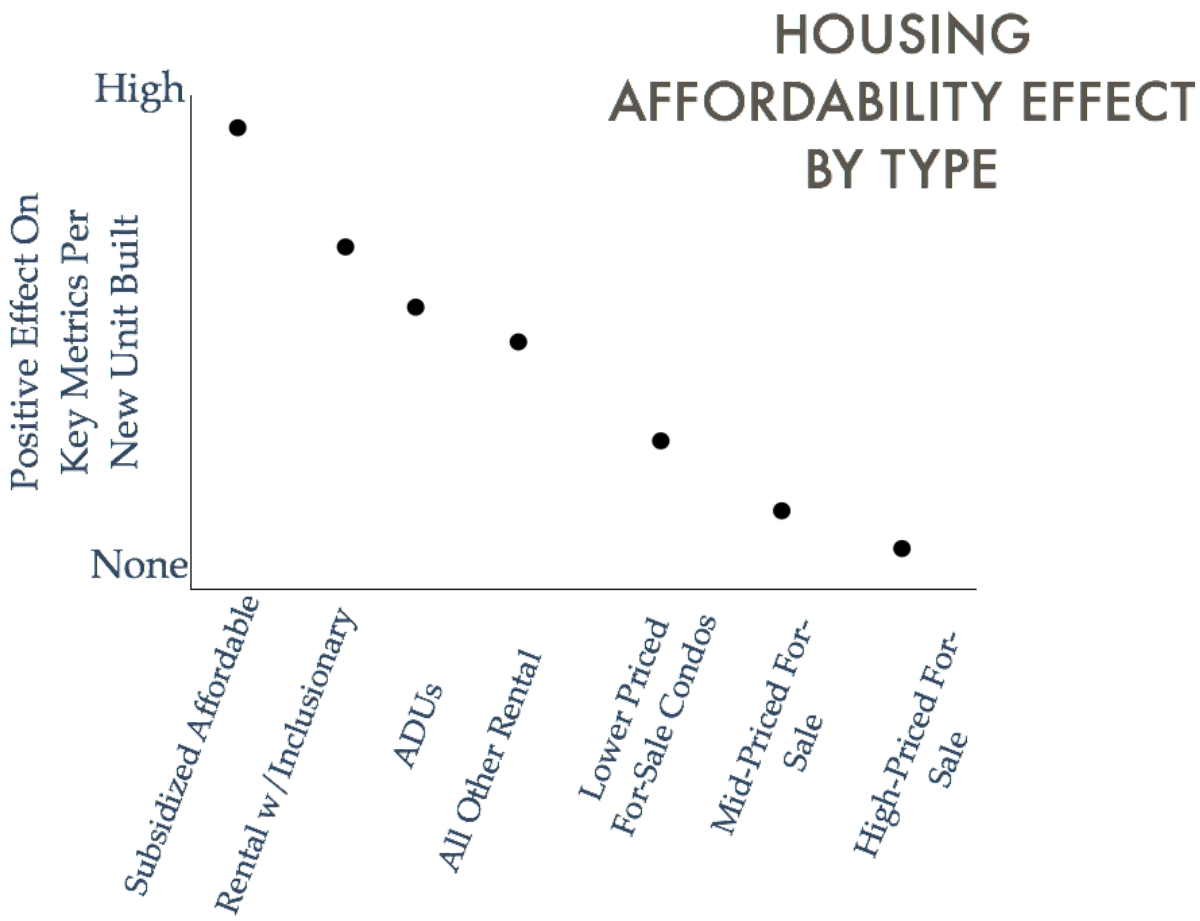
We briefly summarize the most relevant drivers below. The policies advocated in this paper are specifically picked to cause improvements in these drivers.

1. **Overall Housing Supply.** It is well understood that the Monterey Bay Region and California as a whole have for decades been producing new housing at a rate far below the gradual increase in demand. The drivers listed below address the fact that there are more and less productive types of housing to create, but we must not lose sight of the fact that we do not even have in existence today enough housing for our region's current residents. There is no question, then, and that addressing affordability as a whole requires, in part, significant increases in our rate of housing production.

2. **Mix of housing types produced.** A less often discussed component of housing affordability within our undersupplied market is that we (both the Monterey Bay Region and California generally) do not produce a mix of housing types that corresponds well to the spectrum of demand. We create a very small amount of publicly subsidized housing for lower income levels and a much larger amount of expensive for-sale housing (but not even enough of the latter to keep up with demand). Critical to addressing affordability is not only increasing production but altering the types of housing produced. This is important and complex enough that we address this point in more detail below.
3. **Affordable Housing Production.** The more affordable housing we can actually create for lower income levels, all else being roughly equal, the more we will improve the region's affordability. Actually evaluating affordable housing policies according to the number and income level of units produced relative to alternative policies has often been neglected, and is therefore an important part of a systematic policy change effort. There seems no realistic path to addressing most of the affordability crisis via publicly subsidized housing, so this category of production must only be one of several major efforts. Nevertheless, local measures that could create more subsidized affordable housing should be pursued.
4. **Cost of Production.** Even within the context of unaffordably high prices and rents, the high cost of production is one of the dominant factors in the overall lack of supply. Further, it is important to note that while reducing the cost of production does increase total production, it also has the arguably even more important second effect of enabling the production of more housing types (e.g. smaller infill multifamily housing) beyond highest-end units. In this way it is critical to altering the mix of units produced.
5. **Risk in Production.** As with cost, the risk involved, primarily through lengthy and uncertain approval processes, is also a significant component of depressed supply.

More on Housing Types

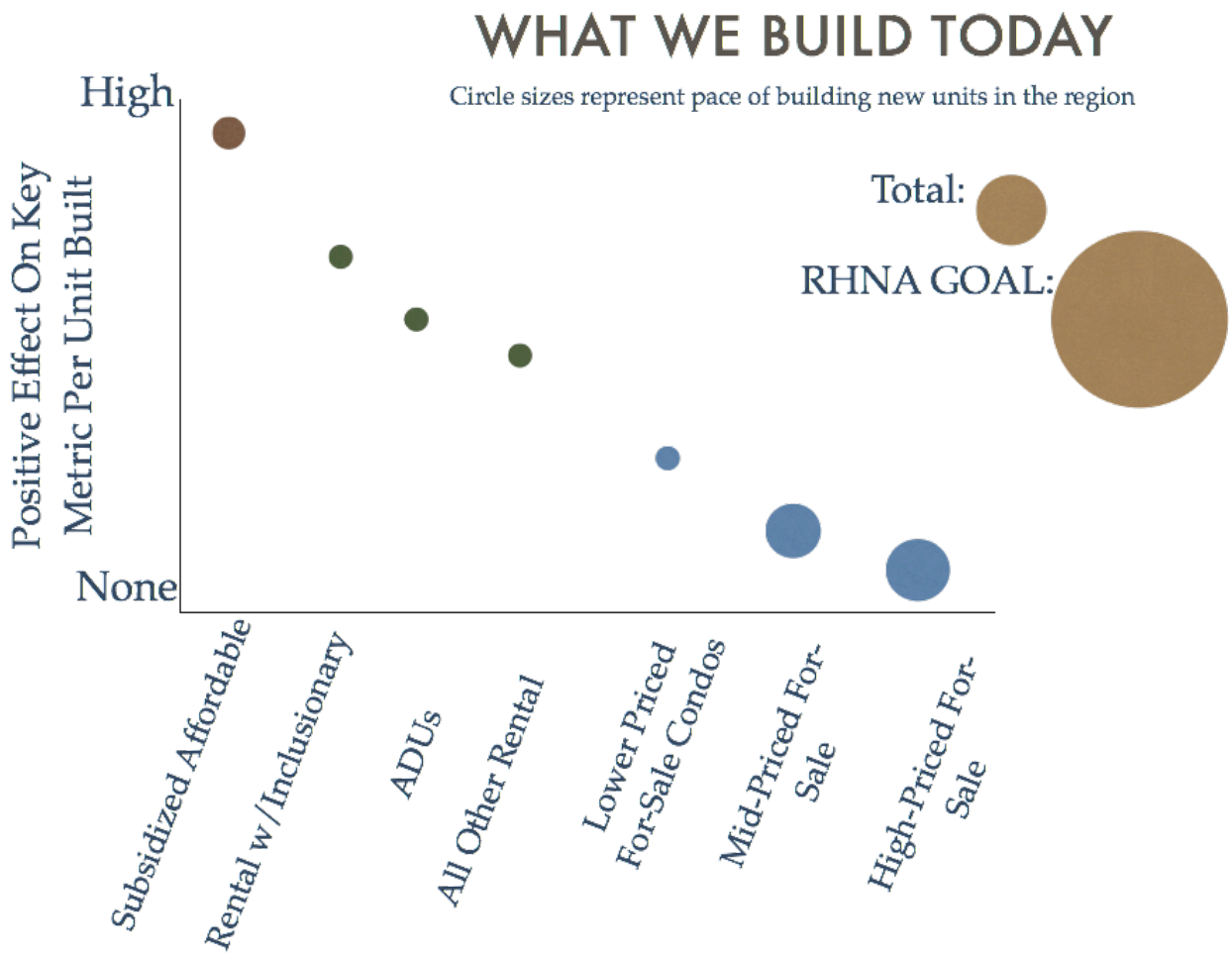
Debate about the effect of new supply on overall affordability is often muddled, in part, by failing to distinguish between new housing of different types. In a region that primarily has lower-growth industries and challenging commutes to higher-growth economic areas (primarily Silicon Valley), some types of new housing construction have low induced demand. Meanwhile, other types of housing, such as for-sale housing that is ideal by design and location for high-end vacation homes, have a larger induced demand for non-primary residence uses. Our region's world class hospitality destinations and desirable retirement communities are in part made possible by service workers who increasingly live further away from their employers. We believe it is likely that our region has an even larger spread in affordability impact between different housing types, and in any case the growing research to support these conceptual distinctions clearly applies.



The types of housing shown above are only some of the categories that warrant consideration - distinction could also be made by dense infill vs. single family homes, multi-family building height, and other characteristics.

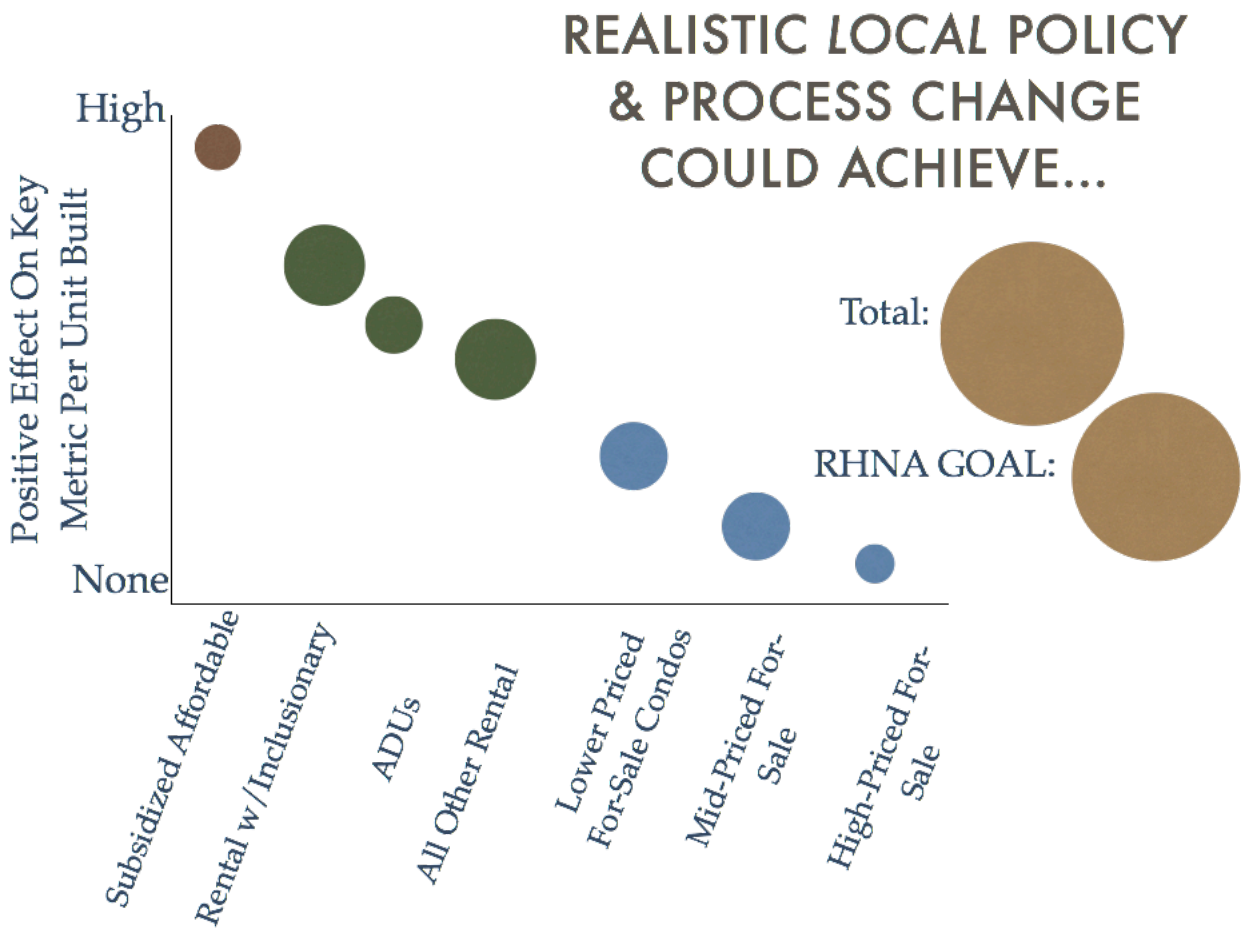
In other regions, work has been done to quantify these distinctions. It is beyond the scope of this report to fully explain this research, which requires first defining combinations of metrics such as median home prices and rents, percent of extremely rent burdened households, new homelessness, etc. to measure. A study by Karen Chapple and Miriam Zuk at UC Berkeley, for example, found that even in the SF Bay Region, both new market-rate housing and new affordable housing actually reduced displacement of lower-income households, with the affordable housing having roughly 2.5 times the effect per unit. While there is not enough data to predict exact affordability improvements in the Monterey Bay Region due to specific increases in supply in specific housing types, we believe the relative effects are clear.

As a rough approximation, the mix of housing types we have built in recent years (more specifically within the last RHNA cycle) looks more like the following, with the size of each circle indicating the relative volume in number of residential units:



The RHNA Goal shown here is the "Regional Housing Needs Assessment" created according to state law that is an estimate of the number of housing units (with sub-goals for certain income levels) that is needed just to keep up with the increase in demand. As can be seen, our region not only adds to unaffordability by failing to keep production up with increases in demand, but also adds further to it by predominantly constructing units that have a lesser affect on overall market affordability.

The good news is that it appears from success elsewhere that realistic local policy change can have a major effect in changing this supply problem. While no single, simple policy change provides the answer, we believe that a systematic, sustained set of local changes and evaluation of their effect could bring our region's housing production close to something like the following, which would begin to reverse unaffordability across income levels:



To accomplish this, jurisdictions in our region would need to systematically and rigorously work on policy changes such as those described in the following section.

Most Promising Policy Change Recommendations

Reviewing local policy recommendations, analysis, and studies of implemented policies by the California Department of Housing & Community Development, the San Diego Housing Commission, multiple policy groups in the San Francisco Bay area, and a few specific jurisdictions has led us thus far to the following list of most promising policy changes that could be made by some or all of the jurisdictions in the Monterey Bay Region.

1. **Scale All Fees by Square Foot, Not Per Unit.** Recognizing that truly reducing the overall fee burden on housing production will likely require state-level policy change, local jurisdictions can immediately focus on removing disincentives to the creation of smaller units. All of the jurisdictions we examined in the region have at least some fees that are charged per housing unit created, without regard to whether the unit is a 4,000 square foot single family home or a 400 square foot rental apartment. This provides a financial

disincentive to build smaller units that have a much greater affect on improving the market's affordability. We see no downside to eliminating this disincentive, as has specifically been recommended by HCD.

We particularly note that in the jurisdictions within Santa Cruz and San Benito counties, the majority of all jurisdiction fees paid in the production of new smaller units are often the per-unit water & sewer fees. For example, a project with 10 units that are each 3 bedroom, 2 bathroom for-sale townhouses of 2,000 square feet might pay $200,000 in such fees (more or less depending on the exact districts the project falls within). In the same location, a project of 15 rental units, 10 of which are 1bedroom, 1 bath, 600 square foot units and 5 of which are 2 bedroom, 1.5 bath, 800 square foot units would pay $300,000 at the same per-unit fee rate. The second project has much less square footage, fewer bedrooms, fewer bathrooms, likely a similar or lower population and number of vehicles, and yet we are disincentivizing it with higher fees. *Just changing these fees alone to a per square foot basis that still nets the same total impact fee collection by water districts could save over 3% on the cost of production of small units in multi-family infill projects.*

2. **Defer Development Impact Fees Until The Certificate of Occupancy.** Paying fees during the most speculative stages of a project's development and then financing fees throughout multiple years of a projects development and construction adds measurably to the cost. The San Diego Housing Commission seeks to save approximately 1% of the cost of production across *all* housing units simply by collecting all of the same fees as a requirement for CoO issuance rather than at many stages throughout a project's timeline previous to that point. This could certainly be done with impact fees, such as those leveed for water, sewer, traffic/street improvements, daycare, affordable housing impact, groundwater/impervious surfaces, parks, schools, etc. Jurisdictions should also look at the many other fees, such as application fees, general plan fees, etc. to determine which are most feasible to move to the later stage as well.

3. **Enhanced Bonus Density Provision.** While real success improving affordability will take changing multiple policies, we see this as the single most powerful lever that could be deployed. It therefore warrants a more detailed explanation.

   Background: The State of California has a bonus density law that applies to all jurisdictions. Under this law, if a housing project includes certain percentages of its units as legally restricted affordable housing units for certain low-income levels, i.e. inclusionary housing (the particular percentage required varying according to how low the income restrictions are on the units), then the project can take advantage of certain incentives, including:

   - A percent increase in the density of units that can be built in the project over that allowed by the local jurisdictions zoning ordinance (with that bonus percent rising as high as 35% if enough income-restricted affordable units are built);

   - A reduction in the minimum parking requirements to a certain level specified by state law, if desired;

   - The right to have a limited number of other more minor deviations from local zoning (e.g. setback requirements) under certain circumstances.

This law seeks to provide the incentives to create affordable housing units without government cash subsidy. However, across California it is rarely used outside of 100% affordable projects that are indeed subsidized with public dollars.

San Diego's analysis concluded that the structure of the law is sound, but often the expense of providing the on-site affordable housing units is greater than the benefit of the incentives provided. Their local amendments to this structure have shown one example of how this bonus density structure can be enhanced to the point that it greatly increases the production of affordable housing units. Key points from San Diego's example include:

- Strategically, San Diego did not reduce the affordable housing requirement to achieve bonus density nor alter the state's bonus incentives for the typical inclusionary housing percentages. Rather, they altered their law to provide a larger bonus density reward for inclusionary housing *above and beyond* the highest levels rewarded by the state. So a project that maxes out the state bonus density incentive by providing 20% of its baseline number of units as low-income affordable units can then provide *even more* inclusionary housing, with more bonus per unit up to a 50% density bonus.
- Similarly, projects going beyond the state density bonus requirement earn more of the minor zoning concessions, up to a five concession maximum.
- **This policy has resulted in a 900% increase in the rate of housing projects applying for bonus density and 470% increase in the inclusionary housing units in the production pipeline.** The increase in affordable and bonus market-rate units is shown in the chart below (courtesy Circulate San Diego at: http://www.circulatesd.org/ahbpreport)

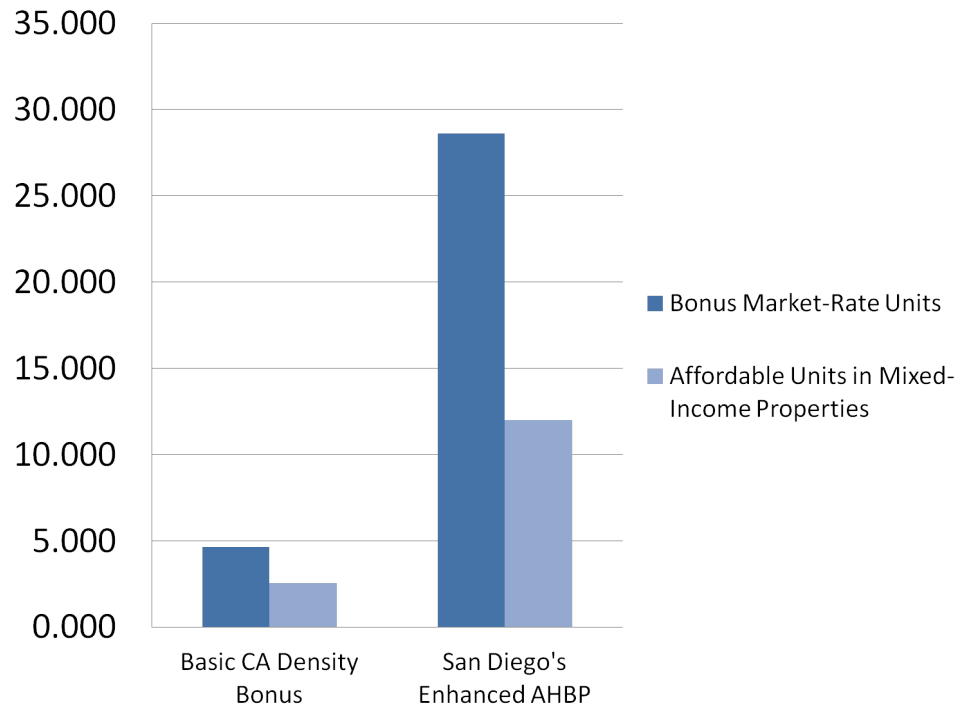
With minor exceptions, all of the jurisdictions in the Monterey Bay Region have bonus density ordinances that effectively copy the requirements of the state law. We see the San Diego framework as a major opportunity for jurisdictions to create affordable housing well beyond what can be funded with public dollars. In addition to the additional bonus structure described above, other potential improvements to the region's current bonus laws for creating affordable housing and other less expensive, denser units include:

- Allow a preference for subsidy vouchers in the inclusionary units, whether to simply lead more such projects to happen or to achieve a deeper level of affordability. (Ordinances in some jurisdictions in the region are unclear as to whether this is allowed.) Arguably the majority of the effectively (and legally) affordable housing in our region comes from the use of subsidy vouchers such as Housing Choice vouchers (aka Section 8), VASH vouchers for veterans, and other programs. However, there is not full utilization of those vouchers we have available in our region because of the difficulty of finding units that will accept them. Within Santa Cruz County, for example, only 50% of those households who get a new voucher (typically after having waited > 8 years on a waiting list), are able to find a unit that accepts the voucher before losing it. This is a major missed opportunity for increasing affordability in our region. As long as this need exists, allowing those vouchers to help pay for the creation of new affordable housing units would be a clear benefit to our region.
- Allow market rate developers the option to pay in-lieu fees and require acceptance of subsidy vouchers. Providing developers alternatives to building inclusionary rental units onsite increases project feasibility, but can be counterproductive in terms of increasing the supply of affordable units. All large-scale rental housing developments (e.g. 10 units or larger) should include some units accessible to lower income households through

subsidy vouchers. The Salinas Inclusionary Housing Ordinance updated in 2017 includes a $5 per square foot in-lieu fee that was higher than economically feasible for some projects, so a compromise was reached allowing developers to pay $2 per square foot if the developer voluntarily agrees to allow Housing Choice Voucher holders to access 12% of their rental units (matching the rental option total percentage). This incentive addresses the need for more access to units for existing voucher holders struggling to find apartment owners who accept their vouchers.

- Rental bonus. As noted above, we desperately need more rental housing in order to improve the region's affordability. Santa Cruz has experimented with adding a rental housing density bonus, in which simply by being guaranteed to be rental housing instead of for-sale units, a project can obtain a density bonus. This hasn't been widely used, however, like other bonus densities. We believe that this is an excellent concept that could be restructured to have a significant effect. Because inclusionary rental units are more difficult financially to incorporate into a rental project, we suggest that jurisdictions structure an additional bonus on top of inclusionary housing bonuses (of, say 10%) for projects that are guaranteed to be rental projects. This would use the San Diego model of still requiring inclusionary units but then increasing the incentive thereafter - in this case for the public benefit of providing rental vs. for-sale housing.

Bonus & Inclusionary Units Produced Per Month in San Diego Before & After Bonus Density Law Change



4. **Reducing Parking Requirements.** The single biggest disincentive for building more, smaller units in a project rather than large, expensive units is parking requirements. In a 3 -

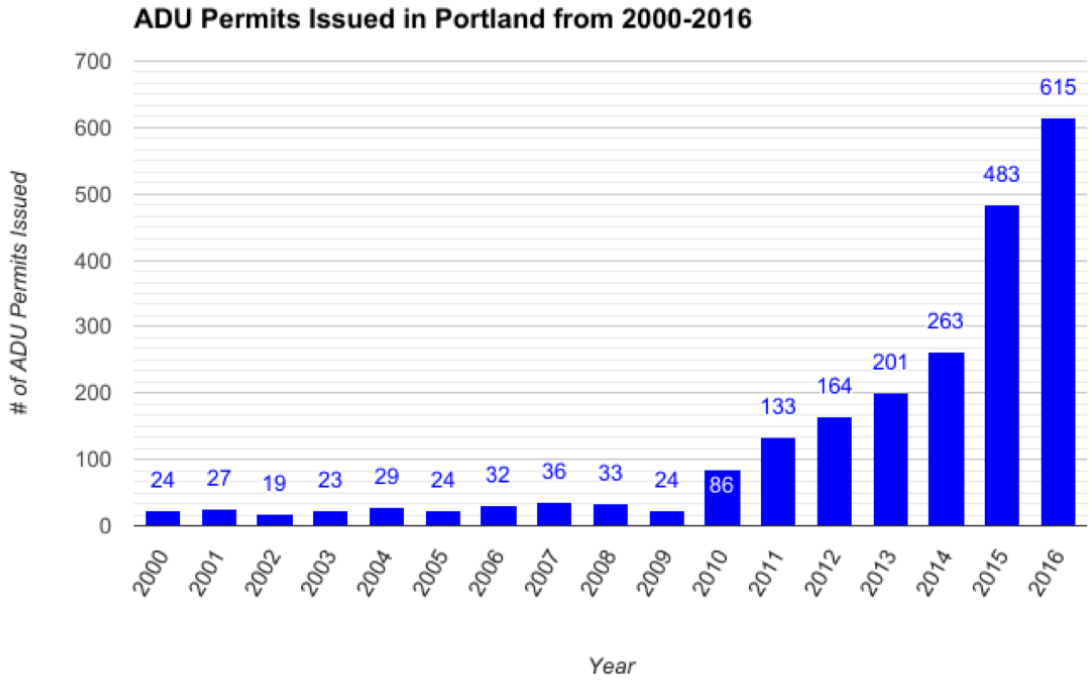
4 story infill project with smaller units, for example, ground-level parking can take up 2.5 times the amount of land as the building(s). Projects then sometimes choose between fewer units (and thus have to get more revenue per unit) or adding structured, underground, or lift parking, which typically costs $20,000/new parking spot or more. The Monterey Bay Region has scores of zoning areas within its 17 jurisdictions with varying parking requirements. But nearly all, for example, require 2 parking spaces plus visitor parking for every modest-sized one-bedroom apartment. The financial feasibility of building many more housing units near jobs in walkable, bike-friendly, and bus-friendly locations would be greatly helped by:

- Greatly reducing - ideally eliminating entirely - parking minimums in core downtown zones, combined with parking districts where needed.
- Reducing parking requirements in other locations served by walkable amenities and public transit.
- Reducing parking requirements as an incentive for lower-parking policies, from additional bike amenities, car sharing amenities, and institution of low-car ownership rental preferences.
- Making a working bonus density ordinance, so that the lower parking requirements required by state bonus density law are available to projects that can work financially.
- Incentivizing commercial property owners to share existing parking with nearby residential projects where appropriate.

5. **Reducing Commercial Space Requirements.** In mixed-use zones around the region, there are typically requirements for how much construction must be commercial or even retail. This can be all street frontage, the full first-floor, or in the case of unincorporated Santa Cruz County, 50% of the square footage of the entire development. In most locations, there is not strong demand for commercial space. Lenders often therefore do not count projected commercial revenue in their financing calculations. This means that housing can only be built in those locations if it is expensive enough to subsidize the required commercial space - often leading to commercial space that is not well designed for likely eventual uses. This is a particularly significant challenge because these mixed-use zones are typically the exact locations where housing density is least controversial, closest to jobs, and best served by transit and active transportation options. Best practices for improving housing affordability include:
   - Allow housing behind and above any first-floor commercial/retail space, requiring at most only a certain depth of commercial space along the primary street frontage.
   - Outside of core downtowns, allow street frontage space to be a construction type and design that can allow for conversion between residential use, live-work space, and retail uses, allowing demand to drive use over time.
6. **Local Funding Sources for Affordable Housing.** 2016 was a breakthrough election cycle for voters in local jurisdictions in CA passing taxes and fees that fund affordable housing. Counties and cities in the Monterey Bay Region should look at best opportunities for generating revenue to subsidize more affordable housing production - sources *other than* taxing the other most important types of housing production (such as rental housing). In fact, jurisdictions who do not have local match sources will not be competitive for state and

federal resources that base their awards on leverage (e.g. Low-Income Housing Tax Credits). Exploration of other local sources could include dedicating a portion of Transient Occupancy Taxes, Cannabis Revenues, or establishing a Commercial Linkage Fee as several San Francisco Bay Area cities have done. UC Berkeley's Urban Displacement Project (http://www.urbandisplacement.org/policy-tools-2) has catalogued affordable housing policies including housing related funding measures across the Bay Area. Los Angeles passed a business sensitive commercial linkage measure in December 2017.

7. **Comprehensive Pro-ADU Production Policies.** The 2016 changes to CA state law remove many of the barriers to ADU production. Nevertheless, longstanding policies in Santa Cruz in particular demonstrate that this is not enough to actually get many ADUs produced. Portland provides the best example of a jurisdiction (roughly the same size as the Monterey Bay Region in total population as well as prevalence of single-family-home lots) that has rapidly increased its ADU production via a systematic policy-change effort. The chart below shows the effect of repeatedly analyzing and acting on policy-change opportunities regarding ADUs in Portland:



Specific policies changed and actions taken beyond those already enacted by California state-wide include:

- Annual production goals, with continued policy change as success relative to the goals is evaluated.
- Significantly lower impact fees for ADUs, including avoiding water and sewer fees due to the property already having such connections.
- Deferral of all impact fees until Certificate of Occupancy.

- No owner occupancy requirements.
- Further lowering parking requirements.
- Easy online tool for assessing a property's eligibility and requirements under zoning rules.
- Sustained public education.
- Actively working with local lenders to encourage the creation of financing products specifically for funding the construction of ADUs.

  For more reading on ADUs, see the recently released brief from Berkeley's Turner Center for Housing Innovation: http://ternercenter.berkeley.edu/uploads/ADU_Update_Brief_December_2017_.pdf

8. **Update Traffic Analysis.** California is moving toward analyzing traffic impacts in the "vehicle miles traveled" framework rather than the "level of service" framework. This recognizes that infill development is better overall for a community's traffic, even if it is near a heavily-used street or intersection, than is building housing far from jobs and services. In November 2017, the Governor's Office of Planning and Research released an update to CEQA that moves this forward. The current estimated timeline by the state is that jurisdictions may not be required to enact this change until some date in the future, potentially as far as the end of 2021. However, the sooner jurisdictions in our region make this switch, the sooner this will positively affect infill housing development. Pasadena, San Francisco, and Oakland have all made this change already and San Jose, Los Angeles, and Sacramento are close to adopting the change. There is every reason for jurisdictions in our region to begin this in 2018.

   (The final draft of proposed state changes can be found beginning on page 77 of http://opr.ca.gov/docs/20171127_Comprehensive_CEQA_Guidelines_Package_Nov_2017.pdf)

9. **Zoning for Density, Including Optimizing Height Limits & Density Calculations.** It is clear that the needed growth in housing supply now and in the future will come from higher-density, infill development. However, our current zoning needs updating in many locations around the region to allow this to occur. Throughout California, jurisdictions are updating zoning in downtowns and denser corridors to enable projects that create new supply of high quality housing (often mixed-use) to occur. These updates include:
   - Setting height limits in downtowns and other denser areas to the financially efficient heights for 3-over-1 (i.e. three residential stories built over one commercial story) and 5-over-2, roughly 50 and 85 feet respectively.
   - Requiring only modest upper-story setbacks, and especially in downtowns, allowing high FAR (floor area ratio) – in these locations a FAR limit is often not needed at all given that total lot coverage after setbacks, articulation requirements, and height limits are observed is often ideal.
   - Removing units-per-acre density limits, instead limiting density by height, FAR, and parking requirements. This enables projects to build more, smaller units in the same building size.

- As stated above, reducing the commercial space requirements is also a core part of optimizing zoning. Outside of core downtown areas, allowing a part of a mixed-use project's ground floor to be residential.

More examples of the specific limits that are preventing more infill density in the most appropriate areas within the region are listed in the table at the end of this document.

Conclusion

Systematic Policy Change Effort

Local policy makers have a major role to play in enabling solutions to our housing affordability crisis. Our local zoning rules, fees, and other policies have not or have not fully implemented many of the best practices being used elsewhere in CA.

It is important to note that many of the locations that are having the most success in addressing these same challenges are taking a systematic, ongoing approach to rapid policy change. Because housing policy is complex, and it is often the combination of many policies that leads to significant change, such an approach is likely necessary for successful outcomes. The approach involves

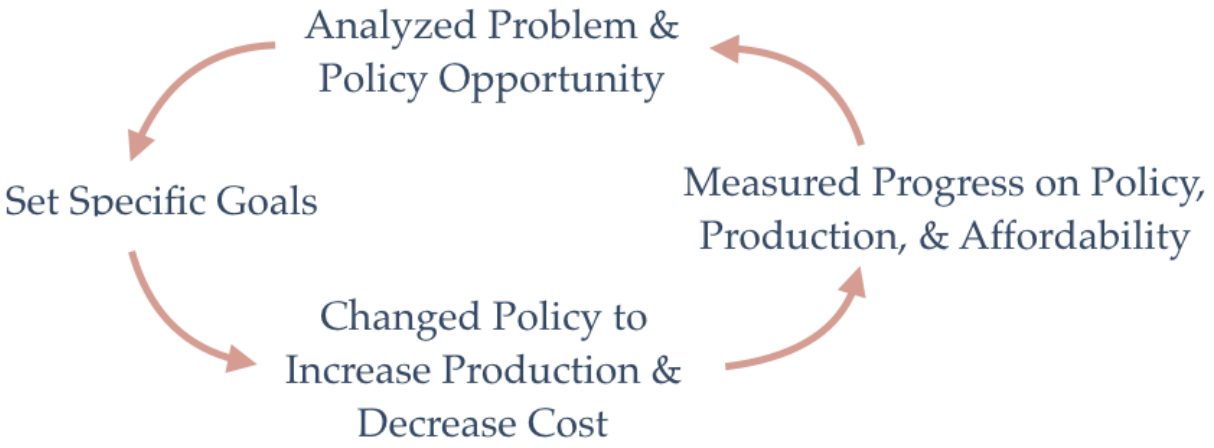
a) Setting annual housing production goals, broken down by components such as units affordable to different income levels, rental vs. for-sale units, and geographic areas.

b) Measuring success against the goals in public annual reports that allow for and encourage community engagement.

c) Taking a data-driven approach to assessing the effect of specific policies in progress toward goals.

d) Sustaining the systematic effort across multiple years, adjusting policies to achieve goals and avoiding critical negative consequences.

The San Diego Housing Commission have been particularly successful at applying this sustained methodology within the context of California's regulatory and funding environment.



A key recommendation, then, is for jurisdictions to engage in a goal-oriented, multi-year process of evaluation and change toward addressing the affordability crisis. This would require a consistent group of appointed commissioners, elected officials, and/or staff to perform clear analysis, incorporating input from residents and the development community before arriving at detailed recommendations. While this takes sustained effort and resources, we are so far behind in having a housing market that supports a healthy, thriving, and diverse community that solutions will require this level of high-priority commitment.

We hope that each jurisdiction will work to carefully adapt and apply these policies, look for more opportunities that have not yet been identified here, and measure the collective progress across:

- Total housing production,
- Production of rental housing,
- Production of affordable housing,
- Displacement and overcrowding, and
- Measures of affordability, including median rent/price, burden relative to income, etc.

Additional Information

When the cost of building a certain type of housing is reduced, more of it tends to be produced. Reducing the cost of building the kinds of housing most needed by a community has become an important strategy in California jurisdictions seeking to address the need for the right kinds of supply. We performed an initial application of public analysis by Kyser Marston Associates for other jurisdictions and by other parties such as HCD and the Bay Area Council Economic Institute to our region and to the policies listed above. This indicates that enacting these policies could save tens of thousands of dollars per unit. For smaller units, this can be well over 10% of the cost of production.

	Applies-To % of Potential Housing	Possible Cost Reduction
Fees by Square Foot	75%	$1-10,000
Defer Development Fees	100%	$2-6,000
Effectively Incentivize Bonus Density Projects	30%	$50-85,000
Reduce Parking Requirements	50%	$5-20,000
Reduce Commercial Space Requirements	20%	$10-20,000

	Applies-To % of Potential Housing	Possible Cost Reduction
Local Funding Sources		n/a
ADU Production Policies	10%	$2-10,000
VMT Analysis	20%	$1-5,000
Optimize Height & Density Calculations	20%	$5-10,000
AVERAGE WEIGHTED TOTAL		>$40,000

The following table captures some of the largest barriers in the region to building small units in high infill density co-located with jobs and services. Hardly any areas in the region utilize best practices of using a combination of building size, height, and parking requirements to achieve higher density. Rather, we have a variety of units/acre density limits that generally are only high density if large units are built.

Recognizing that the specific zoning rules in our region are highly varied, fairly complex, and in many cases undergoing change, we welcome corrections or additions to this information sent to sibley@envisionhousing.us.

Example Zones/Jurisdictions	Largest Barriers to Allowing Optimized Core Infill Density
Salinas Downtown	Units/acre limit in focused growth area of 40 units/acre, other area limits of 24 or fewer
Hollister Downtown	Units/acre limits of 35 or fewer
Watsonville Downtown	Units/acre limits of under 37
Seaside	Units/acre limits of 25, no zone for buildings over 48’
Marina	Units/acre limits of 35 or fewer for residential, 25 or fewer for mixed-use; 50% commercial square footage requirement for mixed-use in core area; no zone for buildings over 50’
Santa Cruz Downtown	3-story limit for some downtown areas, limited downtown zoning area, low % of projects allowed to reach maximum height.
Santa Cruz County Mixed-Use Corridors	50% commercial square footage requirement & 3-story height limit

Example Zones/Jurisdictions	Largest Barriers to Allowing Optimized Core Infill Density
Capitola Potential Mixed-Use Sites	Unit/acre limit of 20