Attachment 1

City of Riverside

City of Arts & Innovation

Housing and Homelessness Committee Memorandum

TO: HONORABLE COMMITTEE MEMBERS **DATE: SEPTEMBER 27, 2021**

FROM: OFFICE OF HOMELESS SOLUTIONS **WARDS: ALL**

SUBJECT: UPDATE ON THE FEASIBILITY AND ECONOMIC IMPACTS OF AN INCLUSIONARY HOUSING PROGRAM FOR THE CITY OF RIVERSIDE – DIRECT SUBMITTAL

ISSUE:

Receive an update on the feasibility and economic impacts of an Inclusionary Housing Program for the City of Riverside.

RECOMMENDATIONS:

That the Housing and Homelessness Committee:

1. Receive an update on the feasibility and economic impacts of an Inclusionary Housing Program for the City of Riverside; and
2. Provide direction to staff on how to proceed with the Inclusionary Housing Program.

BACKGROUND:

In recent years, the State of California has identified the shortage of housing, particularly affordable housing, as a legislative priority. A housing shortage impacts the State's economy, contributes to homelessness, and results in long commutes, increasing production of green-house gas emissions, air pollution, and poor public health. Affordable housing is defined as rent/utilities or mortgage/taxes/insurance/utilities that cost 30% or less of the gross household income and are available to persons who earn at or below 80% of the Area Median Income (or $63,200 for a family of four in 2021).

Facing a rise in local rents and housing costs, a steady rise in homelessness, and a decrease in homeownership associated with the high cost of housing, on May 18, 2021 the City Council and Housing Authority Board authorized the award of an Agreement with Economic and Planning Systems, Inc., to explore the possibility of implementing an inclusionary housing policy in the city of Riverside. By definition, inclusionary housing policies are local policies that could require developers to sell or rent a percentage of new residential units to lower-income residents or pay an in-lieu fee to support the development of such units. To offset the cost of providing affordable housing in all new projects, an Inclusionary Housing Program can offer incentives to developers in the form of zoning concessions such as reduced parking, density bonuses, or tax abatements. Developers can also be given an option to choose an alternative to providing the affordable units in the form of in-lieu fees or providing affordable units at an alternate location. Inclusionary Housing Programs can include both for-sale and rental units and are often implemented through a jurisdiction's zoning code.

DISCUSSION:

The Housing Authority and Planning Division staff have been in discussions with Economic and Planning Systems, Inc., (EPS) regarding preliminary data collection and data validation techniques leading to preliminary findings regarding the viability of an inclusionary housing policy.

EPS participated in a virtual project initiation kick-off meeting with City staff to discuss the overall context of the Project, the City's specific objectives, and key opportunities and challenges for affordable housing development in Riverside. After initial discussions, EPS began its investigations by studying a targeted set of cities in California with approved inclusionary housing programs, including Temecula, Montclair, Highland, Irvine, and San Luis Obispo.

EPS has also assembled a tentative set of "static" pro forma financial models representing a range of rental and for-sale housing prototypes and is using these models to assess the development feasibility of these prototypes under a set of identified inclusionary policy alternatives. EPS then contacted market-rate developers Van Daele Homes, Pelican Communities, Ratkovich Properties, Realm Development, Steven Walker Communities, Diversified Pacific, RC Hobbs, Regional Properties, and Overland Development to verify housing and local market data and to get a developer's perspective regarding inclusionary housing policies from firms building in the Riverside market. EPS also contacted the Habitat for Humanity Riverside and National Community Renaissance to understand the Riverside affordable housing market. Calls with developers were used to check assumptions and confirm development costs for the greater Riverside region utilized in its model.

Initial Findings:

As an initial step, EPS has investigated the inclusionary standards in other communities. Dozens of communities in California maintain inclusionary requirements for rental and/or for-sale housing development, and EPS and City staff selected several that represent communities near, or that otherwise are similar to Riverside. As shown below, the selected communities have requirements that range from 3% to 15% affordable housing units for rental and for-sale developments. The income levels at which the units are required to be affordable also vary by community, ranging from very low-income units (under 50% of Area Median Income) to moderate income units (up to 120% of AMI).

Figure 1 Comparable Jurisdictions – Inclusionary standards for rental projects

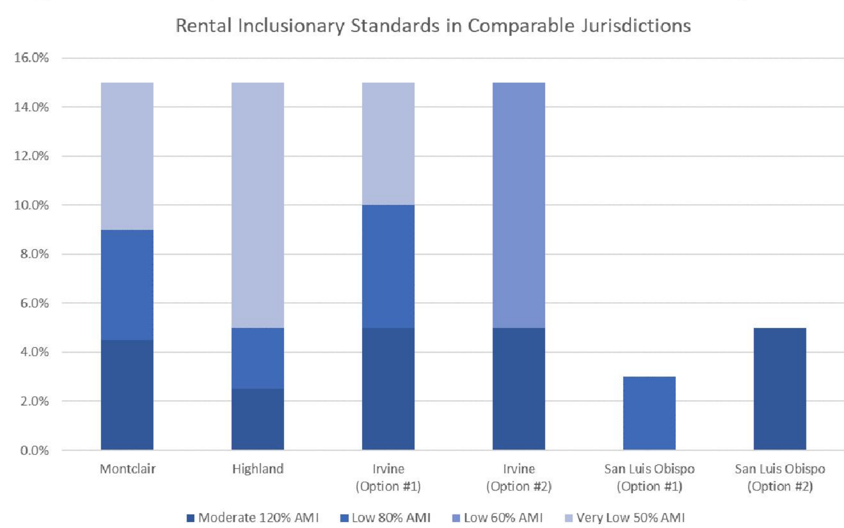
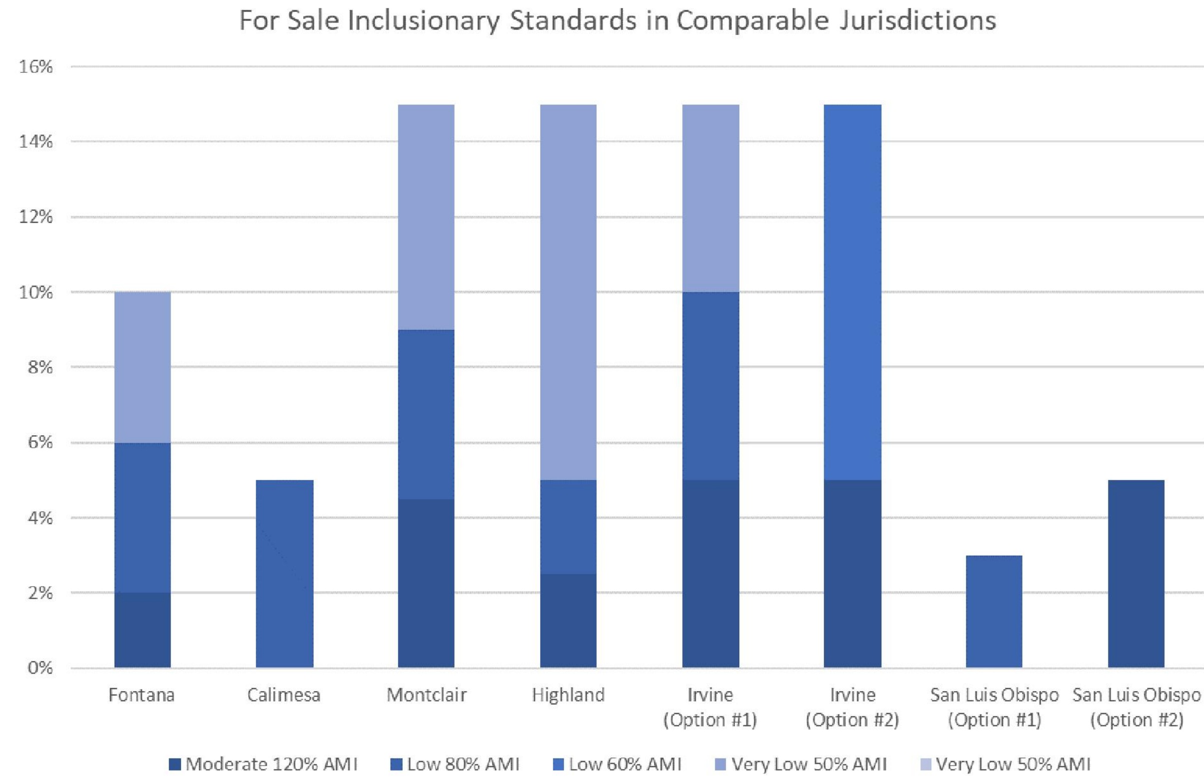


Figure 2 Comparable Jurisdictions – Inclusionary standards for for-sale projects



Note: Fontana and Calimesa do not have inclusionary requirements for rental residential projects.

As illustrated, there is significant variation in inclusionary standards at a basic level – how much and at what income levels – and there is also a variation among jurisdictions regarding the sizes of projects subject to the requirements, whether fees can be paid in lieu of providing units, and other aspects of the programs. It is also true that many jurisdictions do not have inclusionary standards at all, and either rely on other programs to produce affordable housing or do not prioritize such housing other than as required by the State of California.

As a second step, EPS has explored the economic implications of requiring inclusionary standards for new housing construction in Riverside. Inclusionary ordinances require developers to provide a certain number of units at prices below the maximums that the market could support, but the cost to construct the inclusionary units on-site tends to be the same as the market-rate units. Thus, inclusionary requirements lower the development's total revenue potential relative to a fully market-rate project and can limit the profit margin or other financial returns to the developer. If those financial returns fall below rates required to attract investment and secure loans to construct the project, the project is no longer feasible, and the developers and investors will elect to place their money and efforts into other projects or investment vehicles.

EPS worked with City staff to identify five types of housing developments that might be foreseen in Riverside. These include for-sale single-family detached homes (10 units per acre) and attached townhomes (15 units per acre), as well as rental apartments at different densities reflecting their locations in the Downtown (100 units per acre), transit-adjacent areas (60 units per acre), or other neighborhoods of the City (30 units per acre). For each housing prototype, EPS conducted research including developer interviews to estimate the costs of development (land acquisition, construction labor and materials, and indirect costs such as design, entitlement, marketing, etc.) and the market-rate values and revenues that could be achieved. While recognizing that any given project or property will have certain unique attributes – and that the COVID-19 pandemic has dramatically affected the availability and costs of both construction labor and materials – EPS has estimated the typical construction costs and revenues for each prototype under a more stabilized market condition. EPS then compared those costs and revenues without any inclusionary standards to determine whether they met common investment thresholds for feasibility. For the for-sale housing, the threshold was a 15% profit margin (values exceed costs by at least 15 percent). For rental properties, the threshold was a "return on cost" of 5.25%, meaning that the expected net operating income of the project (total rents received less operating expenses) would equal at least 5.25% of the project's total development costs. EPS based these investment threshold assumptions on their experience with comparable transactions, recent market data, and input from regionally active developers as part of the research process.

As shown below, EPS estimates the new market-rate, for-sale housing development in Riverside can achieve returns above the minimum feasibility thresholds. This result allows the possibility that the City might impose at least some level of inclusionary standards on for-sale housing without rendering the project infeasible. As examples, EPS has shown inclusionary scenarios below that can maintain the minimum return thresholds, even as some of the units must be sold for less than they cost to develop. The profits generated by the market-rate units can offset and thus effectively subsidize the deficits specific to the inclusionary units.

Figure 3 Feasibility of Inclusionary Scenarios for Single Family For-Sale Products

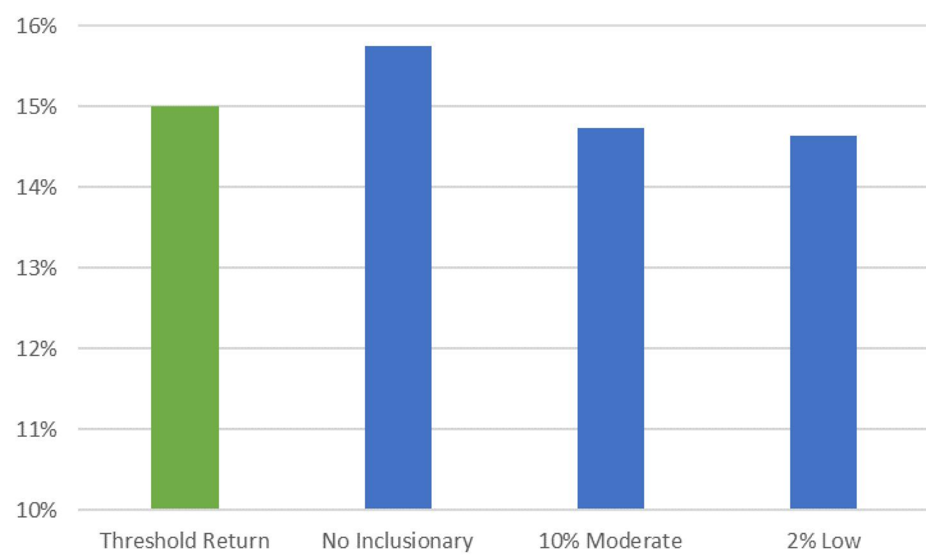
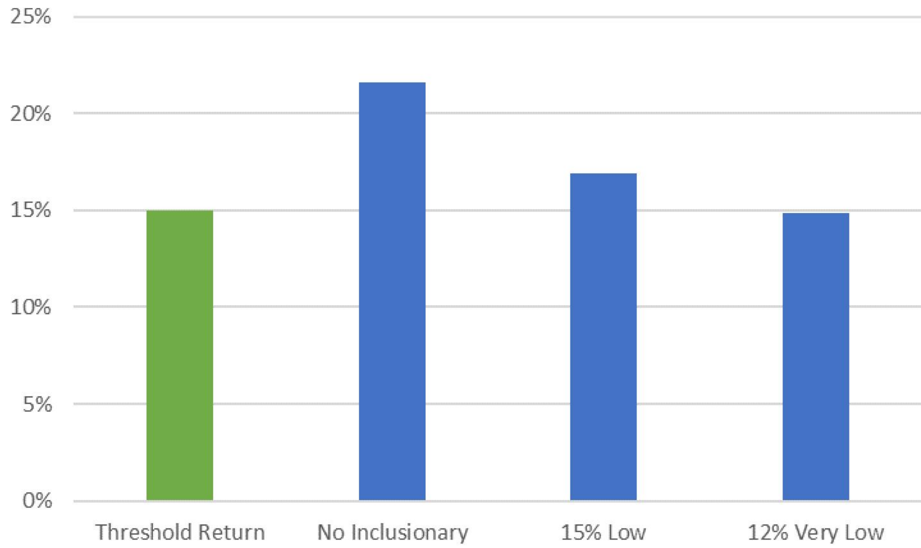
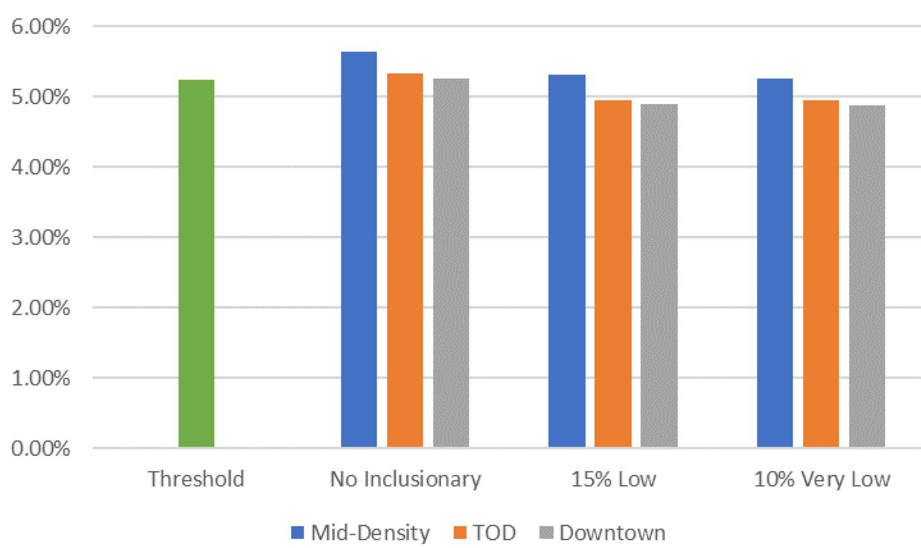


Figure 4 Feasibility of Inclusionary Scenarios for Townhome For-Sale Products



For rental housing, EPS estimates that new market-rate rental housing development can receive at or above the minimum feasibility thresholds. Returns on denser development types in the Downtown and transit-adjacent areas show a return on cost just around the 5.25% threshold, while mid-density types in other parts of the City show a higher return on cost. This is primarily attributable to higher costs associated with developing these products, which are not fully offset by achievable rents. Given this, it may be possible to impose an inclusionary requirement on mid-density multifamily projects without rendering them infeasible, but it is unlikely that higher density infill projects will be able to support similar requirements. Inclusionary scenarios that would be feasible for mid-density projects are shown in the following chart.

Figure 5 Feasibility of Inclusionary Scenarios for Multifamily Rental Products



As a next step, staff and EPS are seeking direction as to whether the City would like to continue to explore an inclusionary housing program for new development. If so directed, staff and EPS will continue outreach to community and industry representatives, test the feasibility of additional inclusionary alternatives, and prepare recommendations for program standards with community participation to begin in late October of this year.

STRATEGIC PLAN ALIGNMENT:

This item contributes to Riverside's Envision 2025 Strategic Priority 2: Community Well-Being and Goal No. 2.1 Facilitate the development of a quality and diverse housing supply that is available and affordable to a wide range of income levels. It also supports Action 2.1.4, Prepare creative land use regulations that include Adaptive Reuse Ordinance, Inclusionary Zoning, Density Bonus Ordinance, and Infill Ordinance to create incentives for housing development.

This item aligns with each of the five Cross-Cutting Threads as follows

1. **Community Trust** – The initiative to explore an inclusionary policy merges best practices in policy development with intensive outreach and communication with both the development community and public to be transparent and make decisions based on sound policy, and inclusive community engagement based on timely and reliable information.

2. **Equity** – Inclusionary Housing promotes the integration of affordable housing into the City's market rate stock which allows people of different races, backgrounds, and economic circumstances to live throughout Riverside, lessening the concentration of poverty and broadening the experiences of those who live in affordable/market mixed units.

3. **Fiscal Responsibility** – By tapping local development resources to ensure a balanced housing market, Riverside is a prudent steward of public funds and ensures responsible management of the City's financial resources while providing quality of life to all residents.

4. **Innovation** – Exploring inclusionary housing potentially creates a development tool to address changing needs and prepares for the future through collaborative partnerships and adaptive processes in consultation with the public and development community.

5. **Sustainability & Resiliency** – By creating a balanced housing market, Riverside is ensuring a balanced economy that serves all income levels of city residents but does not sacrifice growth.

FISCAL IMPACT:

There is no impact to the general fund with this report.

Prepared by:	Michelle Davis, Housing Authority Manager
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