The Economics of Land Use

Report

Inclusionary Housing in the San Joaquin Valley

Prepared for:
The San Joaquin Valley REAP Program

Prepared by:
Economic & Planning Systems, Inc.

August 7, 2023

EPS #221064

Economic & Planning Systems, Inc.
1330 Broadway
Suite 450
Oakland, CA 94612
510 841 9190 tel

Oakland
Sacramento
Denver
Los Angeles

www.epsys.com

Table of Contents

List of Figures

1. Introduction and Study Objectives

Inclusionary housing programs require that new market-rate residential development projects include a certain percentage of housing units at rents or sale prices that are affordable to lower-income households. As an alternative means of compliance for developers, inclusionary housing in-lieu fees are often established as well. Inclusionary housing is often one of many tools cities use to achieve more affordable housing and may be referred to as inclusionary zoning because such policies are implemented through the zoning code.

The first inclusionary ordinances were implemented in the 1970s, and their popularity has grown since. According to a Grounded Solutions Network report, as of 2019 there were 162 jurisdictions within California that have inclusionary housing programs, including four in the San Joaquin Valley.

Initial work on this topic was conducted as part of the recently completed Comprehensive Housing Report for the San Joaquin Valley (https://sjvcogs.org/regulatory-mechanisms/inclusionaryzoning/). Building on that work, this study is intended to respond to the following key questions:

1. How do the real estate economics in the San Joaquin Valley support, or not support, inclusionary policies?
2. What are the production numbers, real estate economics, and fiscal impacts of valley communities that have inclusionary policies?
3. What are the best types of inclusionary policies and alternatives that could "work" in the Valley?
4. Which jurisdictions can benefit most from inclusionary policies?
5. What can CA HCD do to implement programs and assistance to further inclusionary zoning policy adoption?
6. How do inclusionary housing policies align with California's climate change/carbon reduction goals, and what are the social equity impacts of inclusionary housing to disadvantaged communities?
7. How can inclusionary policies be implemented in a manner that addresses community concerns regarding affordable housing, builder concerns of cost, local political implications; and are inclusionary policies a good option overall?

The following report addresses the preceding questions, and the accompanying PowerPoint presentation deck provides an executive summary of the study.

2. Background and Context

The State of California requires every jurisdiction to adequately plan for its community's housing needs, as specified by the Regional Housing Needs Allocation (RHNA), which determines the amount of housing units needed for each jurisdiction by income category. Currently, jurisdictions in the San Joaquin Valley are working towards preparing and adopting their 6th Cycle Housing Elements, reflecting a broad range of policies and strategies to meet current RHNA targets.

As part of the Housing Element update process, many jurisdictions are considering inclusionary housing programs, as they have proven effective at achieving affordable housing in several jurisdictions across the state. However, inclusionary programs are not appropriate for every jurisdiction. Inclusionary housing programs are most effective in jurisdictions already experiencing or expecting strong market-rate development at prices and rents sufficiently greater than development costs.

Pros

- Increases the City's supply of deed-restricted affordable housing as market-rate development occurs
- Helps the City meet its Regional Housing Needs Allocation (RHNA)
- Works synergistically with the State Density Bonus Law
- Provides opportunities for more people to share in the benefits of economic inclusion, integration, and citywide economic growth as market-rate development occurs
- Helps the City achieve federally-mandated Fair Housing goals by addressing issues of segregation and concentrated poverty

Cons

- Adds to the cost of developing market-rate housing (or reduces revenue potential when units are built on-site)
- Inclusionary requirements and in-lieu fees need periodic updating to remain in economic "alignment"
- Requires staff resources to administer the program

Most inclusionary zoning programs follow a similar framework, but the specifics often vary across jurisdictions. When establishing an inclusionary housing program, key considerations include:

- **Percentage requirement:** Most inclusionary requirements are expressed as a percentage of the total units within a development that must be rented or sold at affordable levels. The most commonly adopted inclusionary requirements in California range from 5 to 15 percent. For example, an inclusionary requirement of 10 percent means that 10 percent of the units built must be offered at affordable prices/rents.

- **Affordability level:** Inclusionary requirements usually reflect some combination of units that must be affordable to Very Low-, Low-, and Moderate-income households. Some requirements also include a percentage of units affordable to Extremely Low-income households as well. Some ordinances provide flexibility in their requirements—for instance, by allowing a smaller percentage of inclusionary units if they are more deeply affordable (i.e., affordable to Very Low- or Extremely Low-income households), or by allowing developers to choose the combination of affordability levels provided among the required number of inclusionary units.

- **For-sale versus rental housing:** Inclusionary programs can specify different requirements for rental housing projects versus for-sale housing projects. Typically, for-sale inclusionary policies require the affordable units to be provided at Low- or Moderate-income levels only, as many jurisdictions find it challenging to qualify Very Low-income households for ownership housing due to the additional costs associated with home ownership (e.g., property taxes, homeowners insurance, utilities).

- **Applicability threshold:** Some programs exempt projects below a certain number of units; however, there are also ordinances that place inclusionary requirements on all residential projects, including one- and two-unit projects. In these cases, payment of in-lieu fees is typically allowed for those smaller projects where the percentage requirement would equal a fraction of a unit (e.g., a 10% percent inclusionary requirement for a two-unit project would equal 0.2 affordable units).

- **Affordability length:** Most inclusionary ordinances in California require a 55-year affordability term for rental units, consistent with State Density Bonus Law. However, some jurisdictions choose to lengthen the term to perpetuity. For-sale units are most typically deed-restricted for 45 years with resale or equity share provisions.

- **Alternative means of compliance:** Pursuant to California Government Code Section 65850, an inclusionary housing ordinance shall "provide alternative means of compliance that may include, but are not limited to, in-lieu fees, land dedication, off-site construction, or acquisition and rehabilitation of existing units." In-lieu fees are usually the most preferred alternative method of compliance for developers because it is often less costly (and simpler) to pay the in-lieu fee than to construct affordable units and accept lower prices/rents. Therefore, jurisdictions may want to ensure that in-lieu fees are appropriately set in order to cover the true cost of constructing affordable units. Appropriate in-lieu fees will ensure that developers only choose this option when it is truly more feasible than providing units on site. Other common alternative means of compliance include the option to build the affordable housing units on a different site than the market-rate project; dedicating land (at a different location or on the project site) for the development of affordable housing units; or purchasing market-rate units, renovating them and deed-restricting them to ensure affordability.

Of the 62 cities in the eight-county Valley region, only four have active inclusionary housing ordinances: Ripon, McFarland, Patterson, and Escalon. EPS identified the four jurisdictions with active inclusionary programs based on information from the Comprehensive Housing Report and data from the Grounded Solutions Network. Each of the four jurisdictions has a nuanced approach to the program parameters described above. However, correspondence with city Staff and up-to-date Annual Progress Report information from the State's Department of Housing and Community Development (HCD) indicate that only Ripon's program generates a few inclusionary units from market-rate development and none of the jurisdictions have revenue from in-lieu fee programs. More detail on EPS's review and evaluation of the Valley's active inclusionary programs can be found in **Appendix A**.

3. Approach to Feasibility

In thinking about the potential feasibility of an inclusionary housing program, there are four conditions that need to be in place: market feasibility, development feasibility, administrative feasibility, and political feasibility.

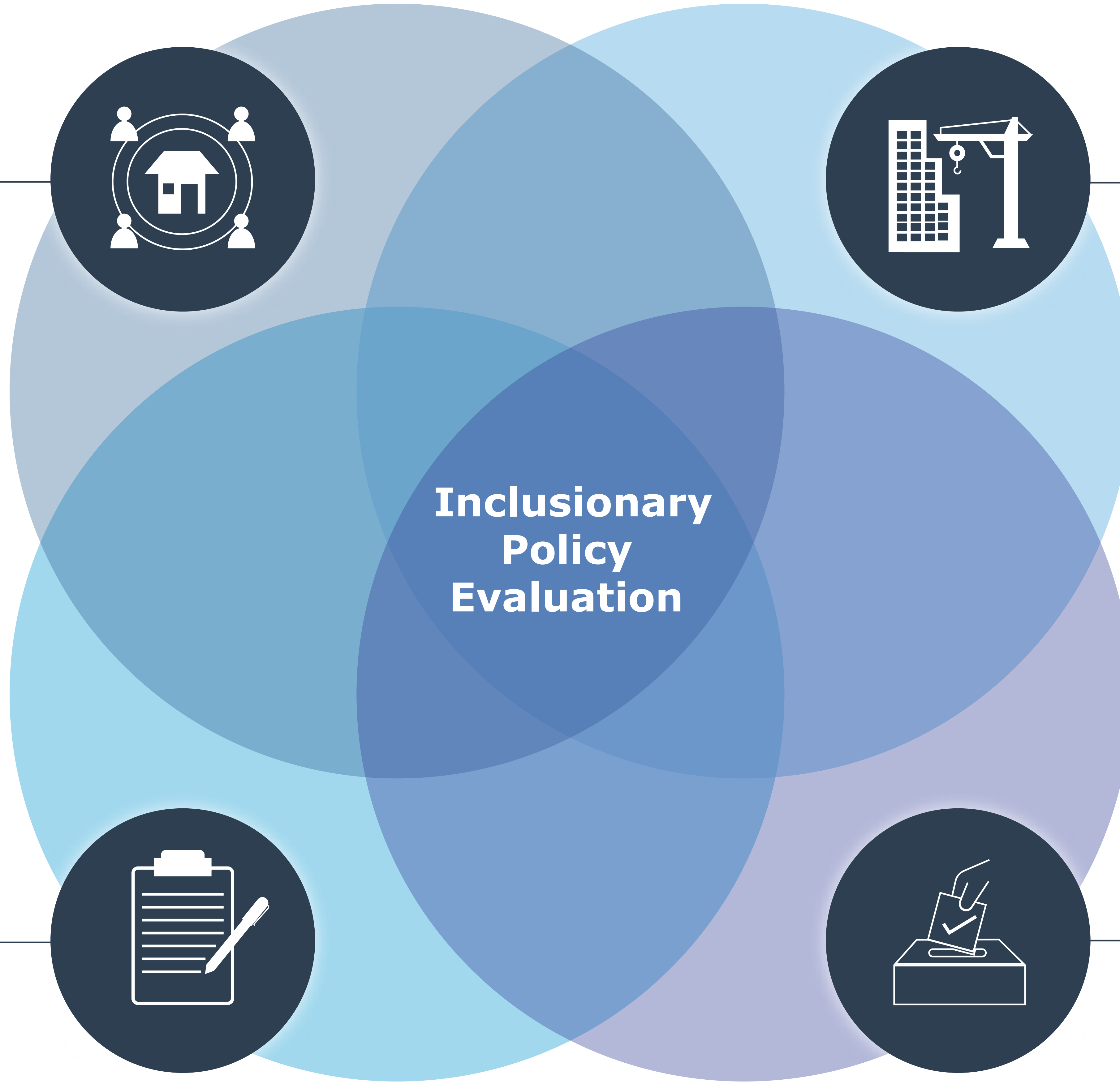
San Joaquin Valley

Market Feasibility

Affordable inclusionary units are only achieved if market-rate residential development is occurring. Evaluating the potential to introduce inclusionary programs in the Valley must consider local residential production and market activity indicators.

Development Feasibility

Assuming new market rate residential development is occurring, what are the rents/sales prices of the new development and how do those values compare with the cost of development? The difference between development costs and market values must be sufficient to absorb the costs (or reduced revenues) of an inclusionary requirement.



Administrative Feasibility

Inclusionary programs require some administrative/staffing support to establish and manage. Critical tasks include tracking and reporting the effectiveness of the program, monitoring the deed-restricted units, and qualifying eligible households. It is important to confirm that there is capacity among current staff (or a plan to expand staff capacity) to manage an inclusionary program.

Political Feasibility

Educating stakeholders and making sure the tradeoffs of inclusionary housing policies are well understood is an important part of successful program implementation. Is there political support among policy makers and elected officials to adopt inclusionary zoning?

Market Feasibility

Affordable inclusionary units are only achieved if market-rate residential development is occurring. Monitoring production trends is straightforward using the California Department of Finance's (DOF) data on statewide housing stock trends as well as data from each jurisdiction's Annual Progress Reports, as submitted to HCD. Steady and robust production trends are an indication that market-rate development is financially feasible. Examining production trends in more detail also sheds light on the types of development that buyers and renters seek.

Development Feasibility

An economic feasibility analysis tests whether new market-rate residential development in a particular jurisdiction can absorb the financial impact of an inclusionary requirement. Such an analysis is intended to provide cities with additional context regarding the implications of adopting inclusionary requirements – namely, whether the additional cost associated with an inclusionary requirement is too great for new residential projects to absorb and would, therefore, make any new residential development in the jurisdiction extremely challenging or even completely financially infeasible.

State law allows jurisdictions, through local police powers, to adopt inclusionary housing ordinances. And while cities are generally not legally *required* to consider any economic or financial impacts when adopting an inclusionary housing requirement, they are often studied and incorporated into the development of these policies to best align a jurisdiction's overall housing goals with its local real estate market conditions.[1]

Residential development pro formas to test the feasibility of introducing inclusionary requirements were prepared for four jurisdictions in the Valley to provide a high-level sense of where inclusionary housing programs may be an effective tool. The methodology and development cost assumptions are described in detail in **Appendix B** and implications are described in each case study write-up.

Inclusionary requirements do impact development feasibility – either by reducing revenue potential (from the onsite, affordable units) or by adding development costs (through payment of the in-lieu fee), but if the program is calibrated to local market and economic conditions, it should not impede new market-rate development.

[1] An exception to this statement is Assembly Bill (AB) 1505, which allows HCD to request an economic feasibility study for inclusionary housing policies that include a requirement that more than 15 percent of total *rental* units developed be affordable to households earning 80 percent of area median income (AMI) or below.

Developers may be able to offset these effects by taking advantage of the State Density Bonus. As previously noted, inclusionary policies work synergistically with State Density Bonus law, which enables developers to subsidize affordable housing units through higher density projects – that is, units provided through inclusionary programs can help a project qualify for the State Density Bonus and associated regulatory concessions. Some developers find the concessions or waivers to be of more economic value than additional density. Some jurisdictions go a step further and adopt local density bonus programs that go above and beyond the State's incentives.

There are also several state and federal grants available to finance the construction of affordable housing units such as Low-Income Housing Tax Credits, Community Development Block Grants, and the HOME Investment Partnerships Program.

Administrative Feasibility

Inclusionary programs require some administrative/staffing support to establish and manage. Critical tasks include tracking and reporting the effectiveness of the program, monitoring the deed-restricted units, and qualifying eligible households. It is important to confirm that there is capacity among current staff (or a plan to expand staff capacity) to manage an inclusionary program. Administrative capacity will be a key consideration for many of the Valley's smaller jurisdictions.

Political Feasibility

Occasionally, all the market and technical and administrative components may align, pointing towards adoption of an inclusionary program in a particular jurisdiction, but it ends up not being supported by elected policymakers. Concerns often arise around inclusionary policies creating tension with the developer community and, as a result, jurisdictions potentially losing out on development opportunities. Educating stakeholders and elected officials and making sure the tradeoffs of inclusionary housing policies are well understood is an important part of successful program implementation.

Holding study sessions with the City Council and inviting representatives of the development community can help educate stakeholders in advance of bringing a proposal forward. The Council of Governments has invested time and resources in studying inclusionary housing and many of the deliverables can be leveraged and used to augment education efforts.

4. Case Study Analysis

To examine the potential for new inclusionary programs in Valley jurisdictions, EPS identified four diverse yet representative cities to study in more detail. The case study cities are spread across the Valley, and they range from small to large, rural to more urban, slow-growing to fast-growing, and lower income to higher income. Two of the four cities already have adopted inclusionary programs and three do not. The case study cities were intentionally selected for their geographic and socioeconomic diversity, so that any Valley jurisdiction can identify with at least one of the case study cities in considering whether an inclusionary housing ordinance could assist in achieving their affordable housing objectives. Moreover, case study jurisdictions were selected to exhibit diverse outcomes. In other words, the case studies were chosen with the expectation that inclusionary housing might be feasible only for a subset of the jurisdictions studied, which may or may not include those with active programs.

As previously noted, while many Valley jurisdictions have indicated an interest in inclusionary programs, only four cities have active ordinances: Escalon, Patterson, McFarland, and Ripon. EPS selected McFarland and Ripon as case studies of these four programs due to the high potential for crucial lessons to be learned from their experiences, especially given their contrasting attributes, such as demographic composition and geographical location. In addition, EPS examined two cities without inclusionary programs: Stockton and Visalia. For each case study, EPS conducted market research, pro forma feasibility analyses, and interviews with City planning or community development department staff.

Because inclusionary housing programs are adopted at the jurisdictional level, jurisdictions that are interested in pursuing an inclusionary housing program will need to conduct their own studies to develop local inclusionary housing policies. However, the case studies depicted on the following pages examine many of the building blocks that Valley jurisdictions would explore to craft jurisdiction-specific programs. The information below provides context on the characteristics of each jurisdiction (from north to south), and the case studies, including the results of the feasibility analyses and implications for other Valley jurisdictions, follow on the subsequent pages.

- **Stockton**: Stockton is a large urban city with 322,489 residents (the third largest in the San Joaquin Valley by population and the 11th largest in California). Located in San Joaquin County, Stockton is uniquely situated within the Bay Area and Sacramento Valley commute sheds. As such, the demand for housing in the Stockton metropolitan area has increased rapidly over the last decade. That said, while Stockton has experienced significant housing development in recent years, much of it has been deed-restricted affordable housing. Stockton accounted for 11 percent of

San Joaquin County's Above Moderate-income development from 2018 to 2021, but half of the county's Low- and Very Low-income housing over the same period. While Stockton's RHNA allocation requires the City to plan for more Above Moderate- and Moderate-income housing, inclusionary housing could still be a valuable tool since the City must plan for over 4,000 Low- and Very Low-income units.

- **Ripon**: Ripon is a small rural city in San Joaquin County with 15,979 residents. One of the wealthiest jurisdictions in the San Joaquin Valley, Ripon has high incomes and high home sale prices. Ripon is a slow growth community, which limits the amount of new development in the city, impacting the City's ability to generate affordable units through its inclusionary program. However, when new development does occur, the inclusionary program works effectively, most often resulting in BMR Plus Affordable units.[2] These units are intended to address the needs of households that earn too much to qualify for deed-restricted affordable housing but not enough to purchase market-rate housing. That said, these units do not count towards RHNA because they exceed HCD's income requirements.

  Likely as a result of a lack of affordable housing, as well as Ripon being entirely composed of Highest Resource and High Resource opportunity areas, Ripon must plan for 820 units affordable to Very Low-, Low-, and Moderate-income households over the sixth-cycle housing element update process – nearly 60 percent of its total RHNA allocation. Therefore, leveraging its existing inclusionary housing program has the potential to greatly assist in helping the City meet its housing goals.

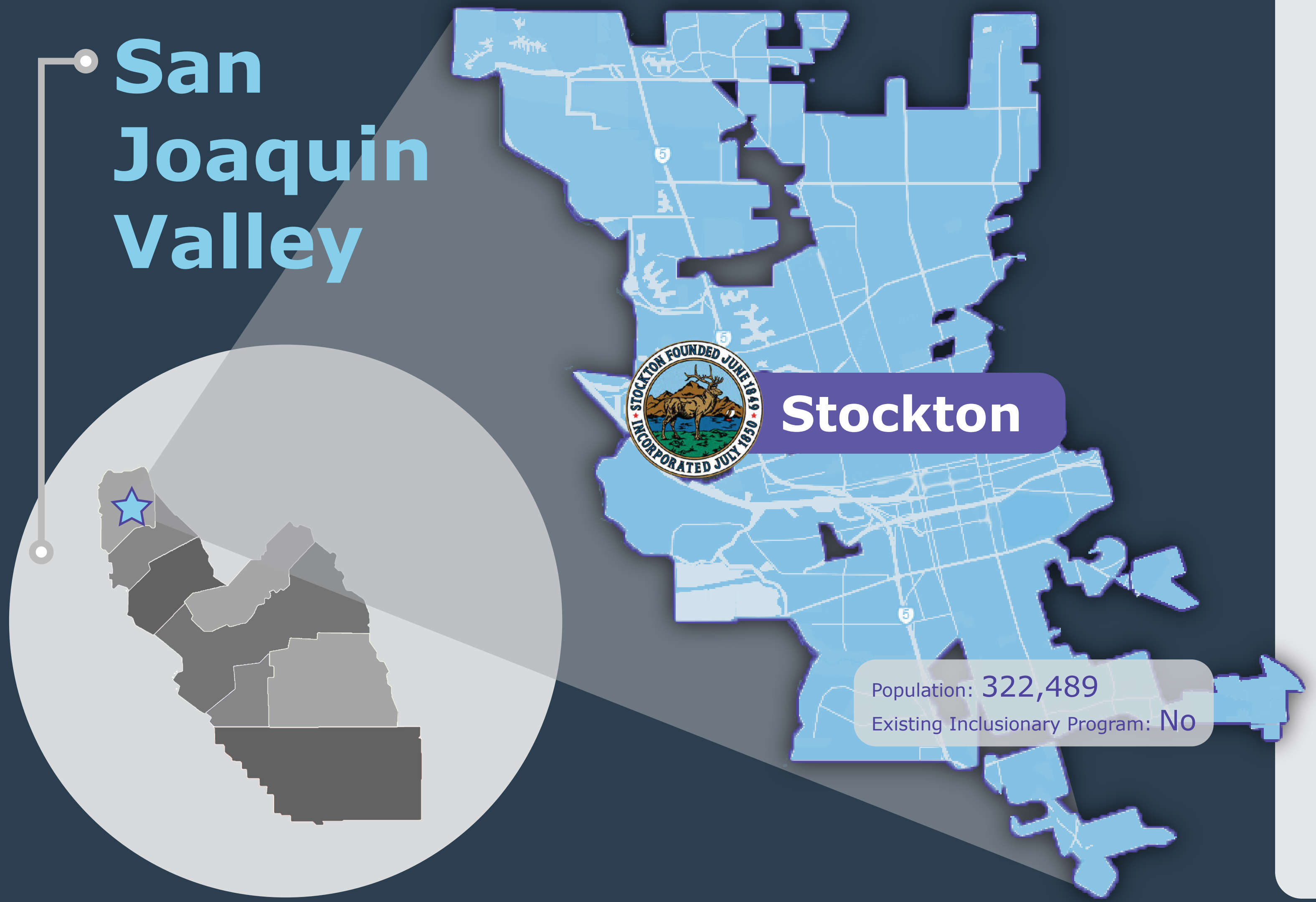
- **Visalia**: Visalia is a mid-sized suburban city in Tulare County with a population of 142,091. The city has experienced substantial growth in housing development since 2018, with most development affordable only to Moderate- (70 percent of growth) and Above Moderate-(23 percent of growth) income households. Visalia may be poised to benefit the most from affordable housing policy tools like inclusionary housing as the City's RHNA allocation is particularly ambitious in its affordable requirement. Specifically, Visalia must plan for nearly 70 percent of its 10,790 RHNA allocation to be affordable at Moderate-, Low-, and Very Low-income levels – the most among the case study cities in percentage terms.

[2] "BMR Plus Affordable" units are defined in Ripon's zoning code as market-rate units with sales prices capped at the upper bound of the FHA mortgage limit for San Joaquin County ($563,500 for a one-family home in calendar year 2022) plus a 3.5 percent down payment.

- **McFarland**: McFarland is a small rural city in northern Kern County with a population of 13,902. McFarland has modest incomes and low home prices and rents. Further, over 90 percent of McFarland's housing development since 2018 has been deed-restricted affordable housing, independent of its active inclusionary housing ordinance, which has generated minimal units due to the lack of market-rate development in the city. Likely due to recent housing element legislation that mandates the prioritization of desegregation and increased income diversity through the RHNA allocation process, McFarland must plan for nearly half of its RHNA allocation to target Above Moderate-income levels.

The case studies summarized in the following pages illustrate the analyses that a city may undertake when exploring the potential to support an inclusionary program. The feasibility analyses and resulting implications for Valley jurisdictions can serve as a general guide for Valley cities to identify opportunities and constraints but should not be taken as individual policy recommendations for the Case Study city. If interested in pursuing inclusionary housing programs, each city will need to conduct their own studies to explore whether inclusionary housing may be an appropriate tool for meeting their affordable housing objectives.

San Joaquin Valley



Housing Production Trends

Market-Rate Development Trends

Market-rate development is occurring at a steady pace.
From 2018 through 2021:

- 960 single-family units were built.
- 264 multifamily units were built.
- 44% of total housing built was affordable to only Above Moderate-income households.

6th Cycle RHNA (2023-2031)

- Stockton must plan for a total of 12,673 units, including 6,088 market-rate units.

Proximity to the Bay Area drives demand and high price points for new market-rate development.

- The median sale price of a newly-constructed home in Stockton is $550,000.
- The average monthly rent for a newly-constructed apartment unit in Stockton is assumed to be $2,182.

Affordable Housing Trends

The City is having success achieving new affordable housing on a project-by-project basis.

- The affordable units produced in Stockton are largely built as 100% affordable, grant-funded projects, primarily with TCAC funding.
- Rather than adopt a comprehensive inclusionary program, Stockton's planning department negotiates inclusionary requirements on a project-by-project basis, reflected through development agreements.

Administrative Capacity

Stockton's planning department consists of two employees. While this does not rule out the potential for a successful inclusionary program, the City's limited administrative capacity would make it challenging to implement and oversee a program at this time.

Stakeholder Support and Political Will

Stockton prides itself on being an "open for business" city for developers, meaning there is a political reluctance to support programs that raise development costs. The BIA in particular maintains a strong presence in Stockton and has expressed concerns about increased development costs. Furthermore, the proximity of smaller cities without inclusionary programs and with less expensive land puts Stockton at a competitive disadvantage.

Development Feasibility

Finding: Single-family ownership development in Stockton is occurring and at profit margins that suggest the potential to support an inclusionary program.

- Prototype: 8 units/acre, 2,000 sq.ft., 3-4 bedrooms
- Per unit development cost: $420,285
- Per unit market value: $550,000
- Profit metric: 31% profit margin (profit as a percentage of development-costs); threshold for feasibility is assumed to be 15%.

Finding: Multifamily rental development in Stockton is occurring and with a yield-on-cost that suggests the potential to support an inclusionary program.

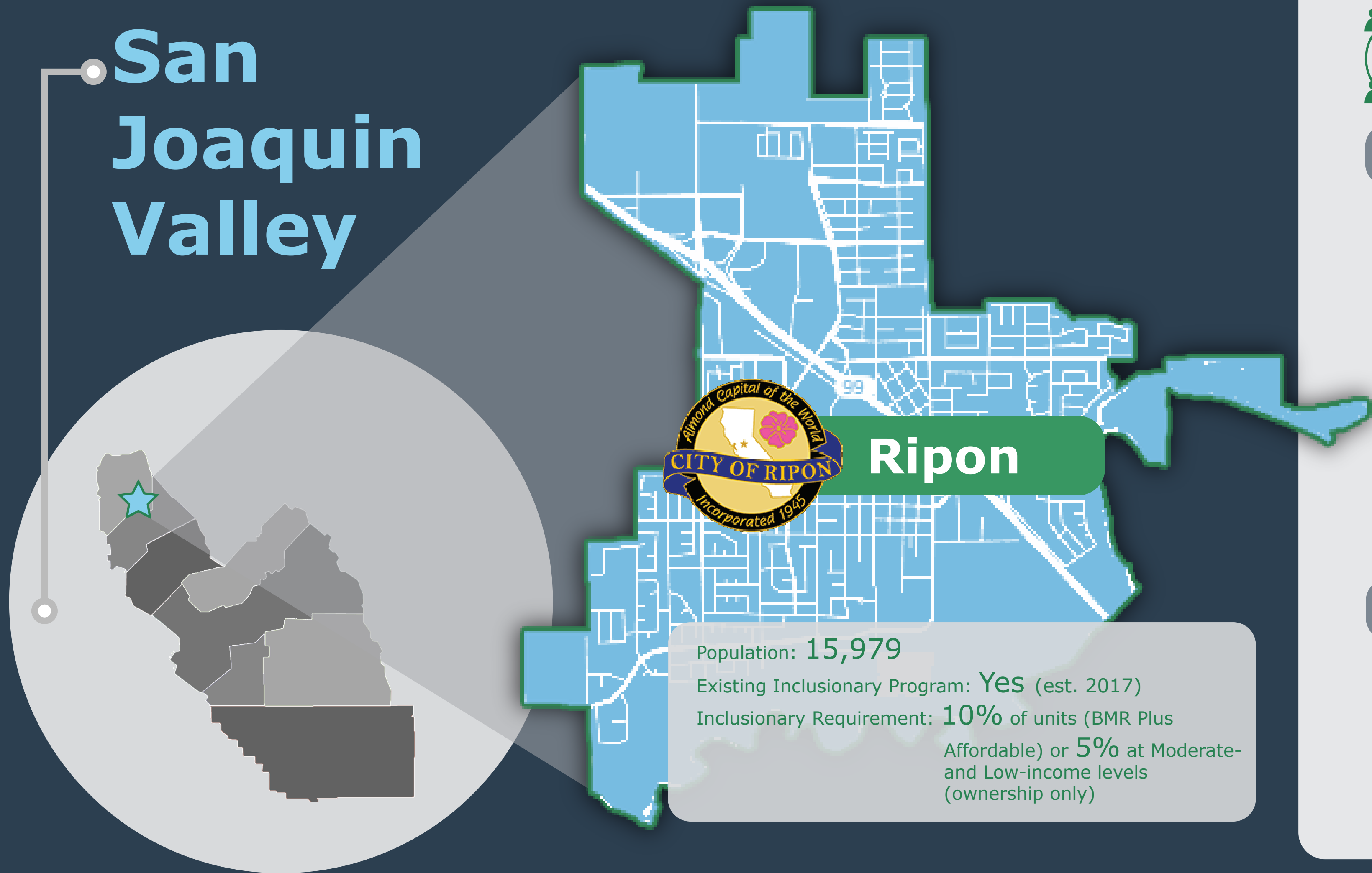
- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $316,501
- Per unit net operating income: $18,688
- Profit metric: 5.9% yield-on-cost (annual net operating income as a percentage of development costs); threshold for feasibility is assumed to be 5.5%.

Lessons Learned and Implications

- Market-rate pricing (sales prices and rents) of newly-constructed product suggests that, on average, new multifamily development can support a modest inclusionary requirement while new single-family development can support a more robust requirement.
- The challenges in Stockton may be the lack of administrative capacity and a lack of political interest.
- Other large, urban Valley cities where population growth is driving market-rate development may be able to support an inclusionary program. Inclusionary housing programs can serve as a tool to mitigate potential displacement caused by incoming residents.

Sources: CA HCD; City of Stockton; CoreLogic Marshall & Swift; CoStar Group; Developer Interviews; LIHTC program applications; Redfin; Analysis by Economic & Planning Systems, Inc.

San Joaquin Valley



Population: 15,979
Existing Inclusionary Program: Yes (est. 2017)
Inclusionary Requirement: 10% of units (BMR Plus Affordable) or 5% at Moderate- and Low-income levels (ownership only)

Housing Production Trends

Market-Rate Development Trends

Market-rate development is occurring at a modest pace and accounts for a majority of recent housing production.

From 2018 through 2021:

- 160 single-family units were built.
- 24 multifamily units were built.
- 98% of total housing built was affordable to only Above Moderate-income households.

6th Cycle RHNA (2023-2031)

- Ripon must plan for a total of 1,424 units, including 604 market-rate units.

New market-rate development is selling at high price points relative to the rest of the Valley.

- The median sale price of a newly-constructed home in Ripon is $700,000.
- The average monthly rent for a newly-constructed apartment unit in Ripon is $2,067.

Affordable Housing Trends

Ripon's inclusionary program, which only applies to new ownership housing, is producing mostly BMR Plus Affordable units, which are not recognized by HCD as deed-restricted units.

- The City's annual progress reports to HCD show that no affordable housing development has occurred in the city over the last few years.
- According to City staff, the program has produced 12 BMR Plus Affordable units since 2018.
- The City does not currently have revenue from in-lieu fees.

Administrative Capacity

City staff in Ripon indicated that the existing inclusionary program works well when new development occurs. However, Ripon is a small, slow growth community, so production is modest. Ripon staff is actively involved in creating affordable ownership opportunities where possible. For example, in addition to the City's inclusionary program, the City also buys homes and resells them at Moderate- or Low-income affordability levels. Staff indicated that the largest barrier to producing HCD-recognized affordable units is a lack of funding from the loss of local redevelopment agencies.

Stakeholder Support and Political Will

Despite the BIA's influence in the region, Ripon has an inclusionary program in place. The City supports inclusionary housing because it provides an opportunity to create mixed-income communities. The City has a strong preference for inclusionary development over fully affordable housing projects to promote income diversity.

Development Feasibility

Finding: Single-family ownership development in Ripon is occurring and at profit margins that suggest the potential to support a robust inclusionary program. The current program may need to be recalibrated to reflect current market dynamics.

- Prototype: 8 units/acre, 2,000 sq.ft., 3-4 bedrooms
- Per unit development cost: $420,285
- Per unit market value: $700,000
- Profit metric: 67% (profit as a percentage of development costs); threshold for feasibility is assumed to be 15%.

Finding: Multifamily rental development in Ripon is occurring and with a yield-on-cost that suggests the potential to support an inclusionary program. The current program does not apply to rental development.

- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $316,501
- Per unit net operating income: $25,748
- Profit metric: 8.1% yield-on-cost (annual net operating income as a percentage of development costs); threshold for feasibility is assumed to be 5.5%.

Lessons Learned and Implications

- Market-rate development trends indicate that new residential development is feasible, with sufficient profit margins to absorb an inclusionary requirement. The current program only applies to developments of more than 10 units, but profit margins suggest that developers may be able to absorb the cost at a lower threshold.
- Other cities in the Valley, where market-rate values exceed the cost of new development by a sufficient margin, may also be able to support an inclusionary program.
- Recalibrating an inclusionary program periodically is critical to ensuring the program reflects current market and economic dynamics.

Sources: CA HCD; City of Ripon; CoreLogic Marshall & Swift; CoStar Group; Developer Interviews; LIHTC program applications; Redfin; Analysis by Economic & Planning Systems, Inc.

San Joaquin Valley

Population: 142,091
Existing Inclusionary Program: No

Housing Production Trends

Market-Rate Development Trends

Market-rate development is occurring at a steady pace.
From 2018 through 2021:

- 1,958 single-family units were built.
- 122 multifamily units were built.
- 23% of total housing built was affordable to only Above Moderate-income households.

6th Cycle RHNA (2023-2031)

- Visalia must plan for a total of 10,791 units, including 3,423 market-rate units.

New Market-Rate development is selling and renting at moderate price points.

- The median sale price of a newly-constructed home in Visalia is $420,000.
- The average monthly rent for a newly-constructed apartment unit in Visalia is assumed to be $2,168.

Affordable Housing Trends

The City is having some success achieving new affordable housing opportunities.

- The market has experienced increased demand for housing in mixed-use zones, particularly for deed-restricted affordable units.
- Visalia has an in-house financial specialist managing the City's CDBG and HOME fund programs.
- 800 affordable units were recently entitled and are expected to satisfy a portion of the City's 6th Cycle RHNA.

Administrative Capacity

The City's planning department is personnel-constrained. However, the department shares collaborative relationships with other City departments, demonstrating the potential to leverage assistance in developing and monitoring an inclusionary program. That said, given the limited potential to support an inclusionary program, an additional administrative burden may not be warranted at this time.

Stakeholder Support and Political Will

Visalia's current Housing Element does not mention an inclusionary program. However, during their most recent Housing Element update, a Technical Advisory Committee made up of affordable housing developers and members of the BIA recommended a program to study several potential affordable housing financing mechanisms, including an inclusionary ordinance. The program was abandoned, however, due to a lack of political support. Developers in Visalia have indicated a preference for efforts that reduce barriers to affordable housing production over the adoption of requirements, such as an inclusionary ordinance.

Development Feasibility

Finding: Single-family ownership development in Visalia faces feasibility challenges and is not likely to be able to support an inclusionary program at this time.

- Prototype: 8 units/acre, 2,000 sq.ft., 3-4 bedrooms
- Per unit development cost: $395,285
- Per unit market value: $420,000
- Profit metric: 6% profit margin (profit as a percentage of development costs); threshold for feasibility is assumed to be 15%.

Finding: Multifamilyrental development in Visalia is occurring and with a yield-on-cost that suggests the potential to support an inclusionary program.

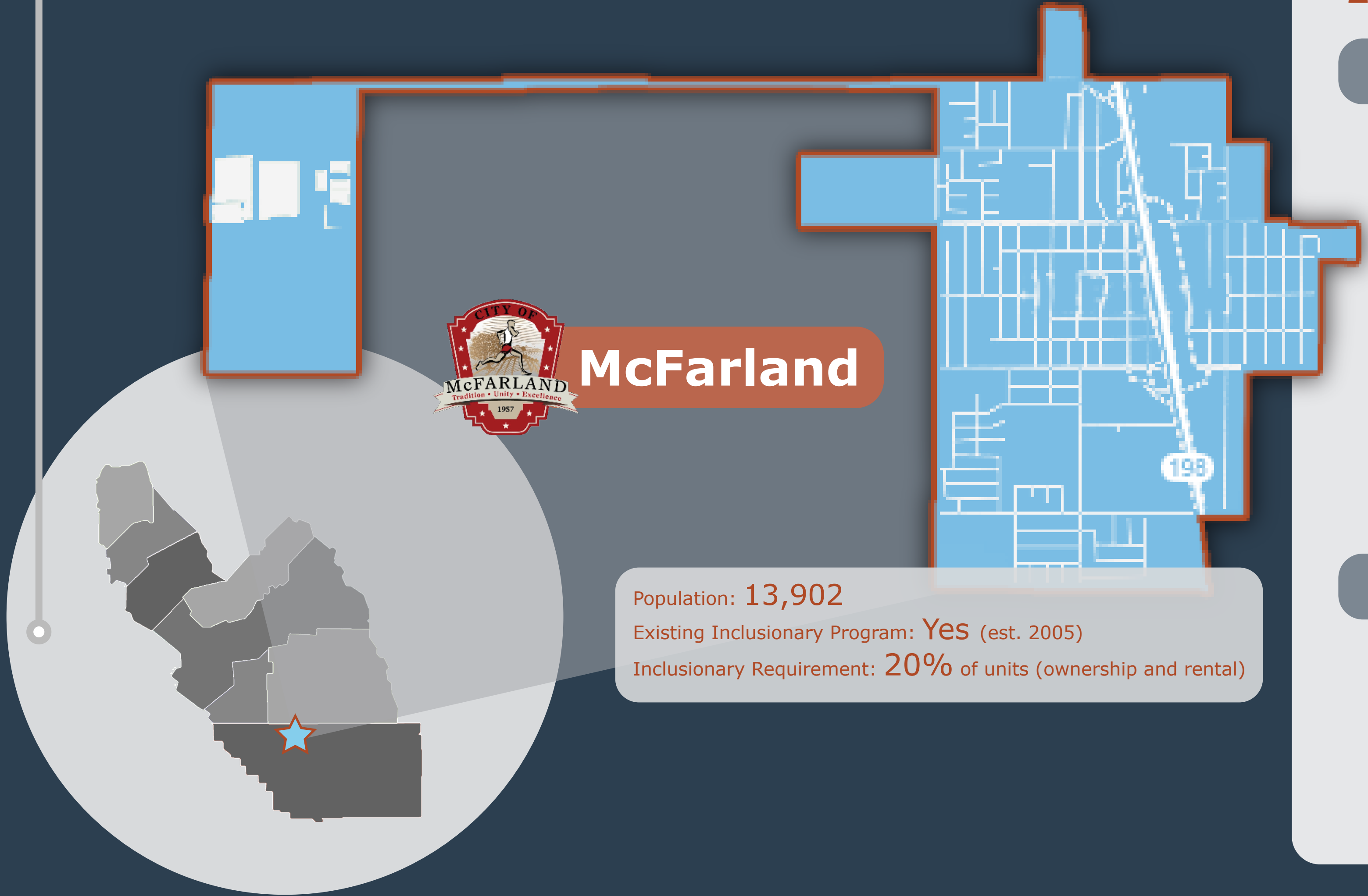
- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $309,834
- Per unit net operating income: $18,519
- Profit metric: 6% yield-on-cost (annual net operating income as a percent-age of development costs); threshold for feasibility is assumed to be 5.5%.

Lessons Learned and Implications

- Market-rate development trends indicate that new residential development is feasible, although development costs are squeezing profit associated with single-family residential development. Sales prices of newly-constructed single-family product relative to costs suggest that new single-family residential development cannot support an inclusionary requirement at this time. Sufficiently high rents, relative to development costs, suggest that the City can support a modest inclusionary requirement on multifamily housing.
- The challenge for Visalia may be a lack of political will and uncertainty around fragile market conditions.
- Other cities in the Valley, where margins of market-rate feasibility differ significantly by product type, may be able to support an inclusionary program under certain circumstances. Cities like this will need to monitor evolving market conditions to find the optimal criteria for an effective inclusionary housing program.

Sources: CA HCD; City of Visalia; CoreLogic Marshall & Swift; CoStar; Developer Interviews; LIHTC program applications; Redfin; Analysis by Economic & Planning Systems, Inc.

San Joaquin Valley



Population: 13,902
Existing Inclusionary Program: Yes (est. 2005)
Inclusionary Requirement: 20% of units (ownership and rental)

Housing Production Trends

Market-Rate Development Trends

Very little market-rate development is occurring in McFarland, and the City must plan for a significant amount of new development as part of its sixth-cycle Housing Element update process.

From 2018 through 2021:

- 76 single-family units were built.
- 0 multifamily units were built.
- Nine percent of total housing built was affordable to only Above Moderate-income households.

6th Cycle RHNA (2023 – 2031)

- McFarland must plan for a total of 244 units, including 117 market-rate units.

The sample size is small, but the data suggests that new development is selling and renting at relatively low price points.

- The median sale price of a newly-constructed home in McFarland is $355,000.
- The average monthly rent for a newly-constructed apartment unit in McFarland is assumed to be $1,994.

Affordable Housing Trends

The majority of new construction in the city is affordable but is occurring independent of the City's active inclusionary housing ordinance.

- About 90 percent of McFarland's housing development since 2018 has been affordable housing – both deed-restricted and "naturally affordable."
- New housing in the city typically falls under USDA rural designation, providing developers with access to Federal grants and loans.

Administrative Capacity

City staffing and resources are limited at this time, and there may not be capacity to properly implement the existing inclusionary program, much less recalibrate it to reflect current market conditions.

Stakeholder Support and Political Will

McFarland has an inclusionary program in place, suggesting that City decision makers, at one time, supported the use of inclusionary housing as a tool to achieve more affordable housing.

Development Feasibility

Finding: Single-family ownership development in McFarland is not occurring at a meaningful pace and new development appears economically challenged, suggesting that the City may want to consider reevaluating its current inclusionary program.

- Prototype: 8 units/acre, 2,000 sq.ft., 3-4 bedrooms
- Per unit development cost: $392,160
- Per unit market value: $355,000
- Profit metric: n/a; development costs exceed values.

Finding: Multifamily rental development in McFarland is challenging at this time, suggesting that the City may want to reevaluate its program.

- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $309,001
- Per unit net operating income: $16,429
- Profit metric: 5.3% yield-on-cost (annual net operating income as a percentage of development costs); threshold for feasibility is assumed to be 5.5%.

Lessons Learned and Implications

- Development trends indicate that new residential development in McFarland is facing significant feasibility challenges.
- Some active inclusionary ordinances in California may be an artifact of a previous period of high market-rate activity and may not reflect current market conditions or a jurisdiction's current priorities.
- Cities in the Valley that are experiencing low levels of market-rate development or low market-rate pricing relative development costs may not be able to use an inclusionary program to their advantage.

Sources: CA HCD; City of McFarland; CoreLogic Marshall & Swift; CoStar Group; Developer Interviews; LIHTC program applications; Redfin; Analysis by Economic & Planning Systems, Inc.

5. Best Practices and Recommendations

Inclusionary housing can be an important tool to help jurisdictions address their RHNA commitments and deliver more deed-restricted affordable housing to their communities. Inclusionary housing is especially effective at ensuring that affordable units reflect a range of product types and are dispersed throughout the community. Unlike 100 percent affordable developments, units provided through inclusionary programs help reduce segregation and concentrations of poverty.

However, inclusionary requirements do affect a market-rate residential developer's financial pro forma, and if the requirements are too onerous, developers will not proceed with the market rate residential projects that jurisdictions want. Setting inclusionary requirements and in-lieu fees is, therefore, a balancing act – and one that needs to be revisited periodically to ensure the program requirements are still aligned with market fundamentals.

For those jurisdictions that are contemplating inclusionary housing programs, a range of implementation recommendations are provided below:

- Reach out to the appropriate Council of Governments (COG) to take advantage of additional research and resources and plan study sessions with your Planning Commissions and City Councils to begin educating stakeholders about the role inclusionary housing programs can play within a community.

- Consider adopting a program but phasing it in or adopting a program that is "triggered" once a certain number of market-rate units are developed.

- Consider an inclusionary program in a specific geographic area (e.g., specific plan areas, near transit, in Priority Development Areas)

- Consider adopting a program with the condition that the effects of the program will be evaluated in one to two years.

- Consider adopting a program with an in-lieu fee that is lower than the equivalent of providing units on-site, knowing that developers will choose to pay the in-lieu fee (unless providing units onsite advances other objectives such as the State Density Bonus). This will allow the jurisdiction to accumulate funds to construct or subsidize affordable housing developments. Alternatively, as mentioned in Chapter 2, the in-lieu fee can also be set to cover the cost of constructing affordable units so as to incentivize developers to build the units onsite and only pay the fee when it is truly more feasible to do so.

- Consider the administrative requirements of managing an inclusionary housing program. Determine if the potential benefits of the program outweigh the administrative costs.

6. Recommendations for the COGs

COGs can play a central role in collecting research and resources and providing education and training materials to their member jurisdictions, thus ensuring that all jurisdictions have access to the same information. The COG can be more efficient in contracting with professional consultants to study issues on a regionwide basis. As an example, COGs in other regions have retained consultant assistance on behalf of member jurisdictions to conduct feasibility studies and draft template ordinances. This type of work can save jurisdictions time and money, although every jurisdiction that wants to move forward with an inclusionary program would need to adopt its own ordinance. Some specific recommendations Valley COGs may consider:

- Continue to monitor residential production trends, development costs, and market prices/rents in member jurisdictions.

- Monitor how the inclusionary programs that are already in place in the member jurisdictions are doing.

- Reevaluate the feasibility of an inclusionary program in two to three years.

- Continue to promote the research and resources that are available and offer education/training to jurisdictions. Specifically, jurisdictions that considered inclusionary housing programs in the past but were concerned about Costa Hawkins and other legal considerations would benefit from recent legislation and case law that clarifies the legality of inclusionary programs for both rental and ownership housing development.

- Develop education/training available to member jurisdictions to reinforce that the State Density Bonus is an incentive-based tool that is available to developers regardless of whether a jurisdiction has a local inclusionary requirement.

7. Recommendations for HCD

Below are three suggestions that could improve the potential effectiveness of inclusionary housing programs in California that would require coordination with HCD.

1) **Prepare a Template for Economic Feasibility Studies.** HCD currently tracks which cities have inclusionary housing programs and requests information about the effectiveness of inclusionary programs through the Annual Progress Report process. In acknowledgement that inclusionary programs must be calibrated to reflect local development costs and market pricing, HCD also requires an economic feasibility study for inclusionary housing policies that include a requirement that more than 15 percent of total *rental* units developed be affordable to households earning 80 percent of area median income (AMI) or below. Just as HCD will be preparing a template for impact fee nexus studies, a template for inclusionary housing economic feasibility studies would also be useful. COGs could then initiate these studies for their member jurisdictions using regional funding.

2) **Recognize "Above Moderate" up to 150 Percent (or so) as Affordable.** HCD tracks affordable unit production according to income category and considers housing that is deed-restricted and available to households earning below 120 percent of AMI to be affordable. However, as market-rate prices increase, households earning more than 120 percent AMI, increasingly, are not able to rent/purchase market-rate housing. Acknowledgement that providing housing affordable to households earning between 120 percent up to the incomes required to rent or purchase market-rate housing would fill a need in many communities that would both benefit Californians and encourage jurisdictions to plan for appropriate housing. Limiting what is considered "affordable" to 120 percent of AMI may be discouraging jurisdictions from developing programs that fit community needs in favor of meeting state requirements. Ripon, for example, produces inclusionary units under the FHA lending program that subsidizes mortgage payments for middle-income households. This option creates ownership and wealth-building opportunities for households that could otherwise not afford to own a home in Ripon. However, because of HCD's income requirements, the units produced in this program do not count towards Ripon's RHNA allocation of affordable units. HCD could provide greater flexibility in its assessment of affordability measures to encourage the design of programs that would best serve each jurisdiction.

3) **Regional RHNA Credits.** Several COGs are establishing housing trust funds to advance housing initiatives in their regions. Jurisdictions with inclusionary programs could give in-lieu fee revenue to the COGs so that there is a critical mass of funding available as opportunities to build housing arise. However,

jurisdictions cannot take any credit towards their RHNA if the new affordable units are not built in their jurisdiction. If a jurisdiction that contributes in-lieu fee revenue towards an affordable housing project could receive credit for the contribution, jurisdictions would be more likely to contribute the revenue towards the most shovel-ready projects in the region. The COG could monitor where the units are being built so that affordable units are built across the region and not concentrated in just one jurisdiction.

APPENDIX A:

Matrix of Inclusionary Housing Programs in the San Joaquin Valley

Matrix of Inclusionary Housing Programs in the San Joaquin Valley

Fresno COG (as the fiscal agent representing the eight San Joaquin Valley regional planning agencies) retained Economic & Planning Systems, Inc. (EPS) to study the implications of inclusionary zoning in San Joaquin Valley communities and recommend best practices for jurisdictions considering inclusionary housing. The dual objective of an effective inclusionary housing program is to simultaneously help produce affordable housing without deterring market-rate development. The study will build on the Comprehensive Housing Report (March 2022) and focus on potential program parameters that are based on a realistic set of market considerations.

Of the 62 cities in the eight-county region, only four cities have active inclusionary housing ordinances. Reviewing these four programs at the outset helps focus the study on the program parameters that are likely to be successful as well as identify features that may not be as effective in Valley jurisdictions.

EPS reviewed Valley jurisdictions' inclusionary programs, contacted them for information on program effectiveness, and prepared this memorandum to report and summarize key findings. EPS identified the four jurisdictions with active inclusionary programs based on information included in the Comprehensive Housing Report and data from the Grounded Solutions Network. In addition, results from a recent survey of the Valley's local community development staff indicated several jurisdictions may be interested in inclusionary programs but have not yet adopted programs.

As part of the review, EPS cataloged and compared key metrics of an inclusionary program such as the threshold project size, the overall inclusionary percent requirement, the targeted incomes levels, and in-lieu fee parameters. The points below summarize key observations from the EPS review.

There are only four active inclusionary ordinances in the San Joaquin Valley, although many Valley cities have indicated interest in developing inclusionary programs. Despite making up 10 percent of California's housing stock and 10 percent of the state's population, the eight-county region has only four inclusionary housing programs versus 240 active programs statewide (or 1.5 percent of total programs). The overwhelming majority of the state's inclusionary programs are in coastal counties, highlighting the strong correlation between increasingly high housing demand (expressed as high market pricing for housing), high land costs, and the need for affordable housing.

Indeed, the San Joaquin Valley is beginning to contend with affordability issues amid rising land costs (as indicated by the City of Ripon in the findings section of its inclusionary housing ordinance), high levels of foreign migration to the Valley, and high domestic migration from housing supply-constrained areas of the state. Highlighting the increasing need for affordable housing in the Valley, particularly in the context of higher 6th Cycle Regional Housing Needs Allocation (RHNA) assignments, survey results from community development staff in Los Banos, Porterville, Reedley, and Stockton indicated they had no active inclusionary ordinances but that it would be a "good tool". Furthermore, the City of Woodlake indicated that their inclusionary ordinance was already in progress. Lastly, despite indicating they had an inclusionary housing program in the survey, the contract planner of the City of Oakdale confirmed that they have no such program, although they do have an active density bonus program.

Each of the four jurisdictions has a nuanced approach to its programs' key parameters, as shown in Figure A-1 and Figure A-2 and described below.

<u>Threshold Applicability</u>

- The City of Escalon's inclusionary housing ordinance applies to all new for-sale and multifamily rental projects of five units or greater.
- The City of McFarland's inclusionary housing ordinance applies to ownership and rental projects of 15 units or greater. Additionally, McFarland requires all new commercial, office, and industrial development to submit an affordable housing proposal and meet with the City to discuss potential incentives for including affordable on-site units or alternatives.
- The City of Patterson's inclusionary housing ordinance applies to ownership and rental projects of more than 10 units.
- The City of Ripon's inclusionary housing ordinance applies to all for-sale development projects of more than 10 units. Ripon does not have an inclusionary requirement for rental projects.

<u>Inclusionary Requirements</u>

- The City of Escalon requires 10 percent to 15 percent of units to be affordable at Very Low-, Low-, and Moderate-income levels and to be constructed in equal numbers, for both applicable ownership and rental projects. The exact inclusionary percentage is chosen on a case-by-case basis by the City Manager, subject to approval by the City Council.
- The City of McFarland requires at least 20 percent of units in applicable ownership projects to be affordable at Very Low-, Low-, or Moderate-income levels and at least 20 percent of units in applicable rental projects to be affordable at Very Low- or Low-income levels.
- The City of Patterson requires 15 percent of units in applicable ownership and rental projects to be affordable. More specifically, ownership projects require nine percent of units to be affordable at Moderate-income levels and six percent of units to be affordable at Low-income levels. In comparison, rental projects require nine percent of units to be affordable at Low-income levels and six percent at Very Low-income levels.
- The City of Ripon allows developers two onsite options:
    - Provide 5 percent of applicable ownership units to be affordable, 3.75 percent for Moderate-income households and 1.25 percent for Low-income households.

    - Set aside 10 percent of units in applicable ownership projects as "BMR Plus Affordable," with sales prices capped at the upper bound of the FHA mortgage limit for San Joaquin County ($563,500 for a one-family home in calendar year 2022) plus a 3.5 percent down payment. The City subsidizes any price differential between the FHA upper bound plus 3.5 percent down payment and the fair market value of the BMR Plus Affordable units at the time of purchase and provides down payment assistance of up to the full 3.5 percent to qualified applicants. This option is intended to help address the needs of households that earn too much to qualify for deed-restricted affordable housing but not enough to purchase market-rate housing.

<u>In-Lieu Fee</u>

- The City of Escalon's inclusionary housing in-lieu fees are not available on the its website. The ordinance states that the inclusionary housing program parameters are reviewed annually by the City Council. Such review could include updates to the in-lieu fees.
- The City of McFarland's inclusionary housing ordinance references the option to pay in-lieu fees (i.e., "the Lower Income Housing Fee). The fee levels are not available on the City's website. EPS will inquire further as part of the in-progress case study research.
- The City of Patterson's inclusionary housing ordinance states that in-lieu fees shall be calculated as a percentage of the projected cost to construct market-rate dwelling units. Furthermore, the calculation of the in-lieu fee shall be approved by resolution of the City Council.
- The City of Ripon calculates in-lieu fees separately for affordable and BMR Plus Affordable units. The in-lieu fee calculation formula for affordable units is based on the difference between the median home price in the City and the applicable Moderate- and Low income affordable sales prices. Meanwhile, the in-lieu fee calculation formula for BMR Plus Affordable Units is based on the difference between the median home price in the City and the applicable FHA lending limit plus the 3.5 percent down payment.

<u>Other Alternative Means of Compliance</u>

- For the City of Escalon, alternative means of compliance include land dedication and potential incentives, including density bonuses, fee waivers and deferrals, development standards waivers, and financial assistance (i.e., either direct financial assistance from the City or assistance in procuring funds from state or federal sources).
- For the City of McFarland, alternative means of compliance include the provision of affordable off-site housing, land dedication, unit credit transfers (from other housing projects within the city), and flexibility in creatively proposing an alternative means of compliance not expressly included in the City's ordinance and that furthers its housing objectives.
- For the City of Patterson, alternative means of compliance include the provision of affordable off-site housing, land dedication, and potential incentives, including density bonuses, fee waivers and fee deferrals, modification of development standards, interior

population needing support, resulting units are not recognized by HCD as “affordable.”

Figure A-1: Summary of San Joaquin Valley Jurisdictions’ Ownership Inclusionary Programs

Jurisdiction	Adopted	Threshold Applicability	Inclusionary Requirement	In-lieu Fee	Alternative Means of Compliance
Escalon	2005	5+ units (4+ in a special case)	10-15% Very Low, Lower, and Moderate (to be constructed in equal numbers)	Parameters reviewed by City Council on annual basis	• Land dedication Potential for incentives
McFarland	2005	15+ units	At least 20% Very Low, Low, or Moderate (20% overall)	Program information for the City’s Lower Income Housing Fee not included in ordinance	• Off-site affordable housing construction • Land dedication • Unit credit transfer • Alternative proposal Potential for incentives
Patterson	2013	> 10 Units	At least 15% overall: 9% Moderate and 6% Low	Based on projected construction costs of Market-rate DUs	• Off-site affordable housing construction • Land dedication Potential for incentives
Ripon	2017	For-sale residential development of 10+ units	10% BMR Plus, or 3.75% Moderate, and 1.25% Low	Calculated by formula	• Off-site affordable housing construction • Land dedication • Conversion of existing market rate units

Figure A-2: Summary of San Joaquin Valley Jurisdictions' Rental Inclusionary Program

Jurisdiction	Adopted	Threshold Applicability	Inclusionary Requirement	In-lieu Fee	Alternative Means of Compliance
Escalon	2005	5+ units (4+ in a special case)	10-15% Very Low, Lower, and Moderate (to be constructed in equal numbers)	Parameters reviewed by City Council on annual basis	• Land dedication Potential for incentives
McFarland	2005	15+ units	At least 15% Very Low or Lower (20% overall)	Program information for the City's Lower Income Housing Fee not included in ordinance	• Off-site affordable housing construction • Land dedication • Unit credit transfer • Alternative proposal Potential for incentives
Patterson	2013	> 10 Units	At least 15% overall: 9% Low and 6% Very Low	Based on projected construction costs of Market-rate DUs	• Off-site affordable housing construction • Land dedication • Potential for incentives
Ripon	No inclusionary housing requirement for rental projects				

APPENDIX B:

Economic Feasibility Analysis

Economic Feasibility Analysis

The economic feasibility analysis evaluates whether new market-rate residential development in four selected Valley jurisdictions can absorb the financial impact of an inclusionary requirement. The selected jurisdictions include Ripon, Visalia, McFarland, and Stockton. The analysis is intended to provide cities with additional context regarding the implications of adopting inclusionary requirements – namely, whether or not the additional cost associated with an inclusionary requirement is too great for new market-rate residential projects to absorb, thereby rendering new residential development extremely challenging or even completely financially infeasible. While cities are generally not legally required to consider these financial impacts when adopting an inclusionary housing requirement, they are often studied and incorporated into developing these policies to best align a jurisdiction's overall housing goals with its local real estate market conditions.[1]

Based on information gathered on market rents and sale prices and the costs to develop new multifamily and single-family housing, this analysis indicates if an inclusionary housing program is an appropriate tool to adopt at this time. To support an inclusionary program, a development prototype must demonstrate feasibility in excess of the feasibility threshold, as described in more detail below. This analysis does not go as far as identifying what level of inclusionary requirements could be feasibly absorbed by different types of new market-rate projects in Valley jurisdictions.

Methodology

Product Prototypes

Prototype residential products used in the feasibility analysis were informed by EPS research on housing market conditions across the Valley. Research included a review of recent developments and proposed projects, discussions with developers active in the subregion, and discussions with staff from several cities.

The prototypes include one rental prototype – multifamily apartments - and one for-sale prototype – single-family detached homes. Densities are constant by prototype and by jurisdiction. The "multifamily apartment" product is assumed to

[1] An exception to this statement is Assembly Bill (AB) 1505, which allows the State's Department of Housing and Community Development (HCD) to request an economic feasibility study for inclusionary housing policies that include a requirement that more than 15 percent of total *rental* units developed be affordable to households earning 80 percent of area median income (AMI) or below.

be developed at a density of 30 units per acre. The “single-family detached” product is assumed to be developed at a density of eight units per acre.

The unit characteristics for each prototype are meant to represent average unit sizes, with the resulting analysis demonstrating feasibility for an average residential project. The findings of this analysis assume that the unique unit mix of any particular project will, in aggregate, conform to these average unit sizes. However, any specific project will have its own cost and revenue factors that its unit mix will partly impact.

The characteristics of each development prototype are summarized in **Figure B-1**.

Figure B-1 Prototype Residential Products

Item	Single-Family	Multifamily
Tenure	For Sale	Rental
Building Type	Detached	Apartments
Density	8 Units / Acre	30 Units / Acre
Unit Bedrooms	3-4 Bedrooms	2 Bedrooms
Unit Square Feet	2,000	1,000
Parking Type	Attached Garage	Surface Parking

Development Cost Assumptions

Housing development costs categories include land acquisition, site preparation, hard costs (e.g., construction labor and materials), and indirect or “soft” costs (e.g., architecture/engineering, entitlement, financing, marketing, etc.). **Figure B-2** provides additional detail about each development prototype and associated development costs. For projects at densities that will require additional parking costs (e.g., structured, subterranean, or covered/uncovered surface parking arrangements), EPS identifies parking costs as a separate line item. Data from recent developments and land transactions in the Valley have been combined with information from interviews with developers who are active in the region to inform the development cost assumptions used in this analysis. **Figure B-3** and **Figure B-4** below detail the cost assumptions and estimated costs per unit for the single-family detached and multifamily apartment unit product prototypes, respectively.

Figure B-2 Development Prototype and Development Cost Categories

Item	Description	Sources
Development Prototype		
Density	Units permitted per acre, for each development prototype.	City zoning code; City staff input; developer input
Unit Size	Average size of a unit.	CoStar; developer input; Redfin
Parking Requirement	Number of parking spaces required per unit.	City zoning code
Development Costs		
Land Costs	Acquisition of land. Varies by location.	CoStar; developer input; LIHTC program applications; transactions of vacant land proposed for residential use
Site Preparation	Demolition (if needed), grading, horizontal infrastructure.	Developer input; EPS experience
Hard Costs	On-site work (labor and materials), vertical construction, general requirements, overhead and builder fees (excl. parking costs). Varies by prototype, with denser development costing more on a per square foot basis.	Developer input; cost estimators (CoreLogic Marshall & Swift, Leland Saylor); EPS experience
Parking Costs	Hard costs specific to parking. Analysis assumes uncovered surface parking at $7,500 per parking space.	Developer input; EPS experience
Soft Costs	Architecture and engineering; entitlement and fees; project management; consultants; marketing, commissions, and general administration; financing and charges; insurance; and contingency. Assumed to be a percentage of hard costs.	Developer input; EPS experience

Figure B-3 Single-Family Detached Product Prototype Unit Cost Assumptions

Item	McFarland Assumptions		McFarland Per Unit	Ripon Assumptions		Ripon Per Unit	Stockton Assumptions		Stockton Per Unit	Visalia Assumptions		Visalia Per Unit
Development Program												
Density	8	units/acre		8	units/acre		8	units/acre		8	units/acre	
Unit Size	2,000	sq.ft.		2,000	sq.ft.		2,000	sq.ft.		2,000	sq.ft.	
Amount of Parking	2.0	per unit		2.0	per unit		2.0	per unit		2.0	per unit	
Development Costs												
Land Costs	$75,000	per acre	$9,375	$300,000	per acre	$37,500	$300,000	per acre	$37,500	$100,000	per acre	$12,500
Site Preparation	$10	per sq.ft. of land	$54,450	$10	per sq.ft. of land	$54,450	$10	per sq.ft. of land	$54,450	$10	per sq.ft. of land	$54,450
Hard Costs	$120	per sq.ft.	$240,000	$120	per sq.ft.	$240,000	$120	per sq.ft.	$240,000	$120	per sq.ft.	$240,000
Parking Costs	$0	per space	$0	$0	per space	$0	$0	per space	$0	$0	per space	$0
Subtotal, Direct Costs			$294,450			$294,450			$294,450			$294,450
Soft Costs	30%	of direct costs	$88,335	30%	of direct costs	$88,335	30%	of direct costs	$88,335	30%	of direct costs	$88,335
Subtotal, Indirect Costs			$88,335			$88,335			$88,335			$88,335
Total Development Costs			**$392,160**			**$420,285**			**$420,285**			**$395,285**

Analysis by Economic & Planning Systems, Inc.

Figure B-4 Multifamily Apartment Product Prototype Unit Cost Assumptions

Item	McFarland Assumptions		Per Unit	Ripon Assumptions		Per Unit	Stockton Assumptions		Per Unit	Visalia Assumptions		Per Unit
Development Program												
Density	30	units/acre		30	units/acre		30	units/acre		30	units/acre	
Unit Size	1,000	sq.ft.		1,000	sq.ft.		1,000	sq.ft.		1,000	sq.ft.	
Amount of Parking	1.5	per unit		1.5	per unit		1.5	per unit		1.5	per unit	
Development Costs												
Land Costs	$75,000	per acre	$2,500	$300,000	per acre	$10,000	$300,000	per acre	$10,000	$100,000	per acre	$3,333
Site Preparation	$10	per sq.ft. of land	$14,520	$10	per sq.ft. of land	$14,520	$10	per sq.ft. of land	$14,520	$10	per sq.ft. of land	$14,520
Hard Costs	$210	per sq.ft.	$210,000	$210	per sq.ft.	$210,000	$210	per sq.ft.	$210,000	$210	per sq.ft.	$210,000
Parking Costs	$7,500	per space	$11,250	$7,500	per space	$11,250	$7,500	per space	$11,250	$7,500	per space	$11,250
Subtotal, Direct Costs			$235,770			$235,770			$235,770			$235,770
Soft Costs	30%	of direct costs	$70,731	30%	of direct costs	$70,731	30%	of direct costs	$70,731	30%	of direct costs	$70,731
Subtotal, Indirect Costs			$70,731			$70,731			$70,731			$70,731
Total Development Costs			**$309,001**			**$316,501**			**$316,501**			**$309,834**

Analysis by Economic & Planning Systems, Inc.

Revenue Assumptions

For the for-sale prototype, the value of the unit is equal to the sale price. The estimated cost of development shown in **Figure B-3** is subtracted from the value to calculate profit, and the profit is divided by the estimated cost to calculate the relevant feasibility metric, profit margin.

For multifamily apartments, the value used to determine feasibility is annual net operating income (NOI), calculated as annual rent minus annual operating expenses (which are assumed at $7,500 per unit in this analysis). To determine the relevant feasibility metric, yield on cost, the NOI is divided by development cost (see in **Figure B-5**).

Feasibility Thresholds

The assessment of financial feasibility for real estate development products is based on calculating financial return metrics for the products and comparing them against typical industry target thresholds. In the case of residential development, relevant return metrics are based on comparing total project revenues to total project development costs.

- For for-sale housing products (typically single family detached and attached homes, including townhomes and condominiums), the feasibility threshold is based on the return metric of "profit margin," calculated as the percentage by which total project value exceeds total project cost. Based on EPS research and feedback from the developer community, the analysis assumes that developers in the Valley will require at least a 15 percent profit margin on for-sale development projects. Therefore, a market-rate project attaining a profit margin at or above 15 percent would be considered feasible in this analysis. A profit margin in excess of 15 percent would be required to support any additional requirements, such as an inclusionary requirement.

- For rental housing products (typically, multifamily apartments), the feasibility threshold is based on the return metric of "yield on cost," calculated by dividing the annual net operating income (NOI) by the total costs of development.[2] Based on EPS research and experience, the analysis assumes that developers in the Valley will require a yield on cost of at least 5.5 percent. A yield-on-cost in excess of 5.5 percent would be required to support any additional requirements, such as an inclusionary requirement.

It is important to note that these return metrics do not account for the time value of money and are not based on any assumption regarding project timeline. EPS assumptions for prototype revenues and costs used to calculate the return metrics

[2] Net operating income reflects total rent collected minus operating costs.

are detailed below in **Figure B-5**. Note that development feasibility alone is not sufficient to support an inclusionary program. Revenues must sufficiently exceed development costs to support onsite inclusionary requirements.

Figure B-5 Development Feasibility Summary

Item	McFarland	Ripon	Stockton	Visalia
Prototype		For-Sale, Detached Single Family		
Per Unit Development Costs	$392,160	$420,285	$420,285	$395,285
Per Unit Market Value	$355,000	$700,000	$550,000	$420,000
Profit Metric	-9%	67%	31%	6%
Supports Inclusionary?	X	✓	✓	X
Prototype		Multifamily, Rental Apartment		
Per Unit Development Costs	$309,001	$316,501	$316,501	$309,834
Per Unit Net Operating Income	$16,429	$25,748	$18,688	$18,519
Profit Metric	5.3%	8.1%	5.9%	6.0%
Supports Inclusionary?	X	✓	✓	✓

Key

✓	Can Support an Inclusionary Program
X	Cannot Support an Inclusionary Program at this Time

Analysis by Economic & Planning Systems, Inc.