INCLUSIONARY HOUSING IN THE SAN JOAQUIN VALLEY

Executive Summary

Prepared for: The San Joaquin Valley REAP Program

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The Economics of Land Use

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STUDY OBJECTIVES

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?

STUDY OBJECTIVES

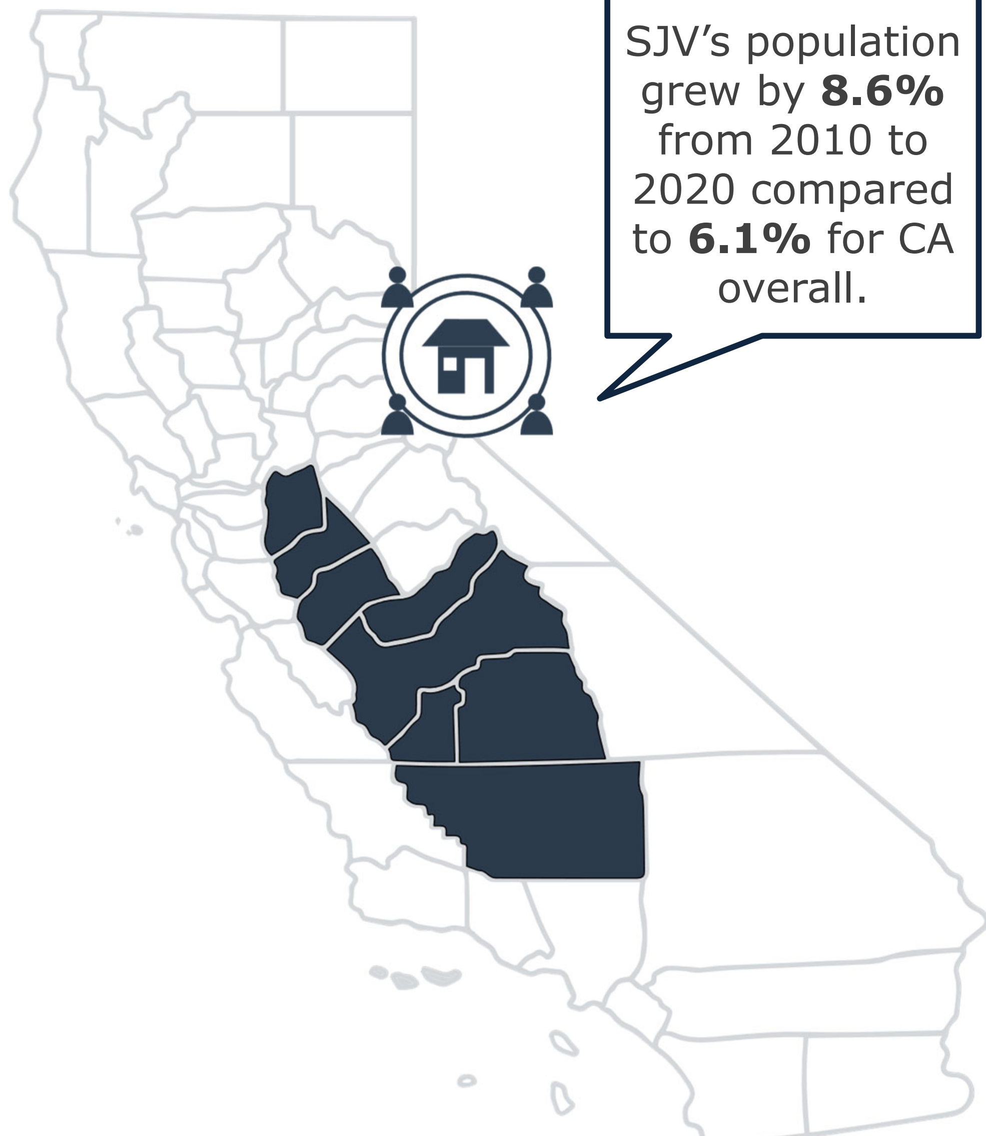
5. What can the CA Dept. of Housing and Community Development (HCD) do to implement programs and assistance to further inclusionary zoning policy adoption? What can the Valley COGs do?

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?

VALLEY MARKET CONTEXT

- SJV is among the fastest-growing regions in CA.
- As in much of the state, the cost of living is rising.
- Over the next RHNA cycle, SJV Counties are expected to plan for 116,478 Very Low- and Low-Income units.
- **Inclusionary housing is one of many tools cities *may be able to use* to achieve lasting affordable housing.**



SJV's population grew by **8.6%** from 2010 to 2020 compared to **6.1%** for CA overall.

INCLUSIONARY HOUSING

Requires 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

Pros

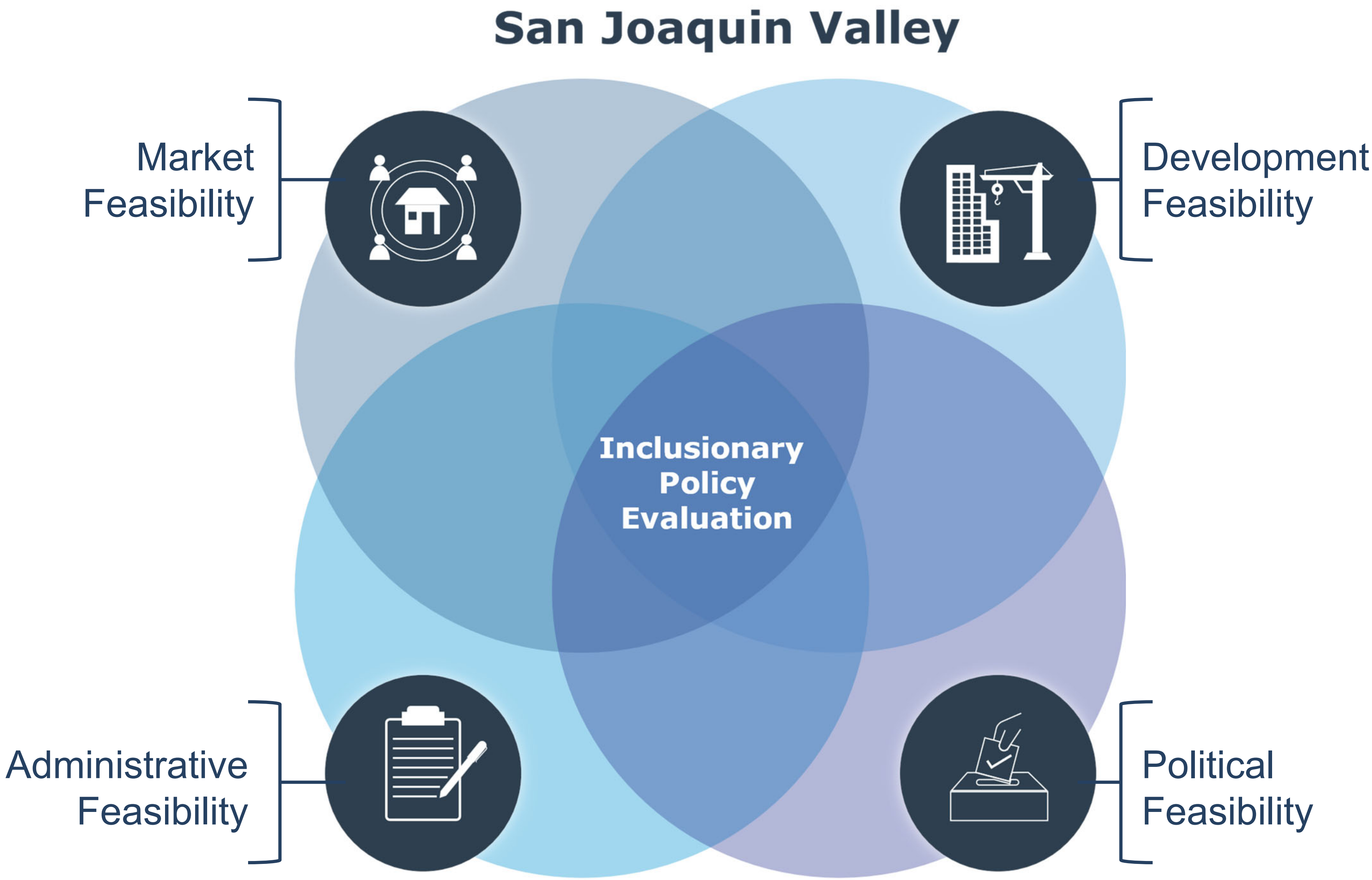
- Increases the city's supply and variety of deed-restricted affordable housing as market-rate development occurs
- Helps the city meet its Regional Housing Needs Allocation (RHNA)
- Works synergistically with the State Density Bonus Law
- Provides opportunities for more people to share in the benefits 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
- Allows lower-wage workforce to live in/near the communities in which they work, decreasing commute times and, thereby, reducing emissions

INCLUSIONARY HOUSING

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
- Deed restrictions can limit value appreciation for lower-income, ownership units, and moderate unit price restrictions are often released at first sale and no longer guarantee affordability

WHAT IS NEEDED FOR INCLUSIONARY TO WORK?



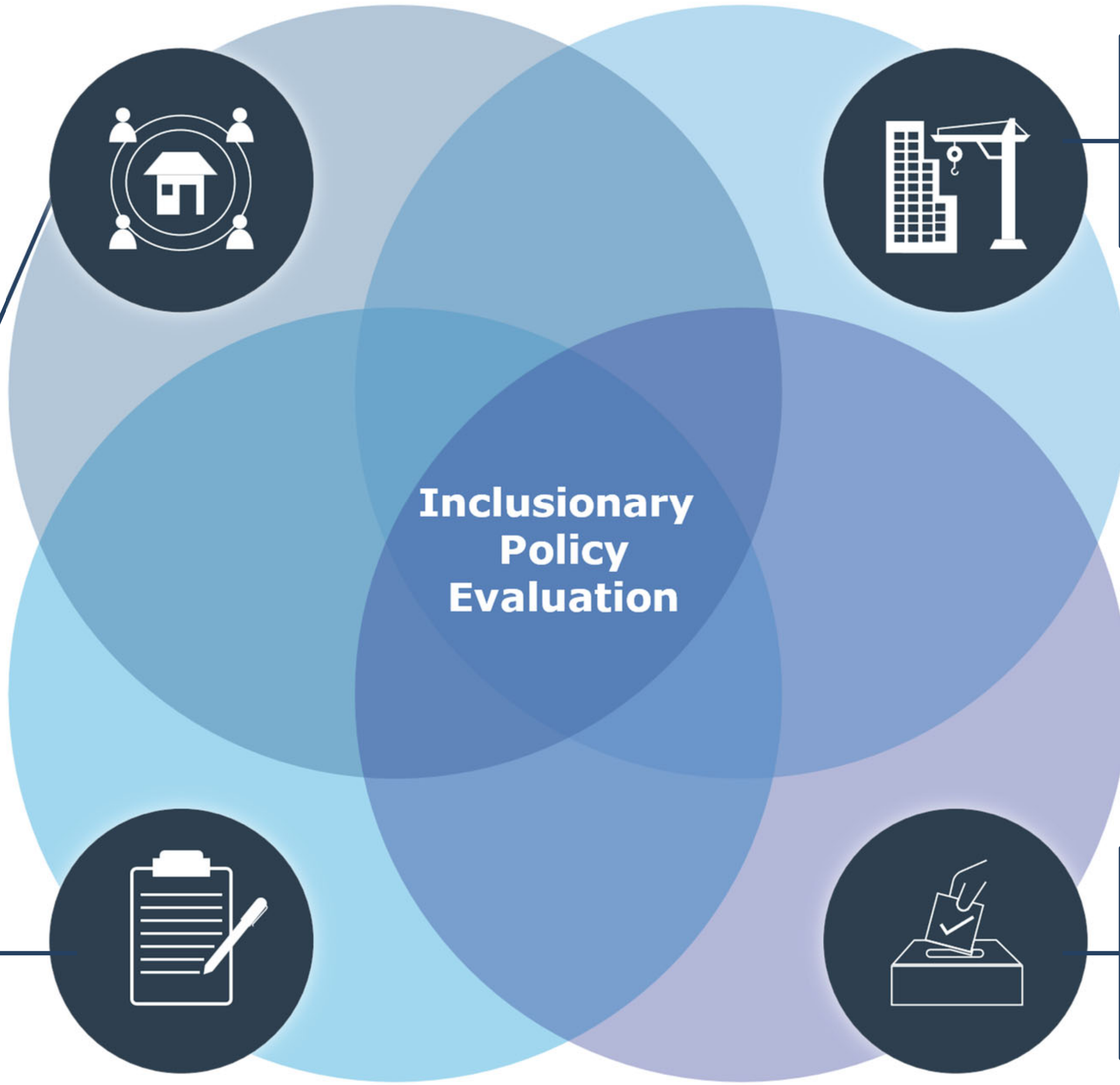
WHAT IS NEEDED FOR INCLUSIONARY TO WORK?

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

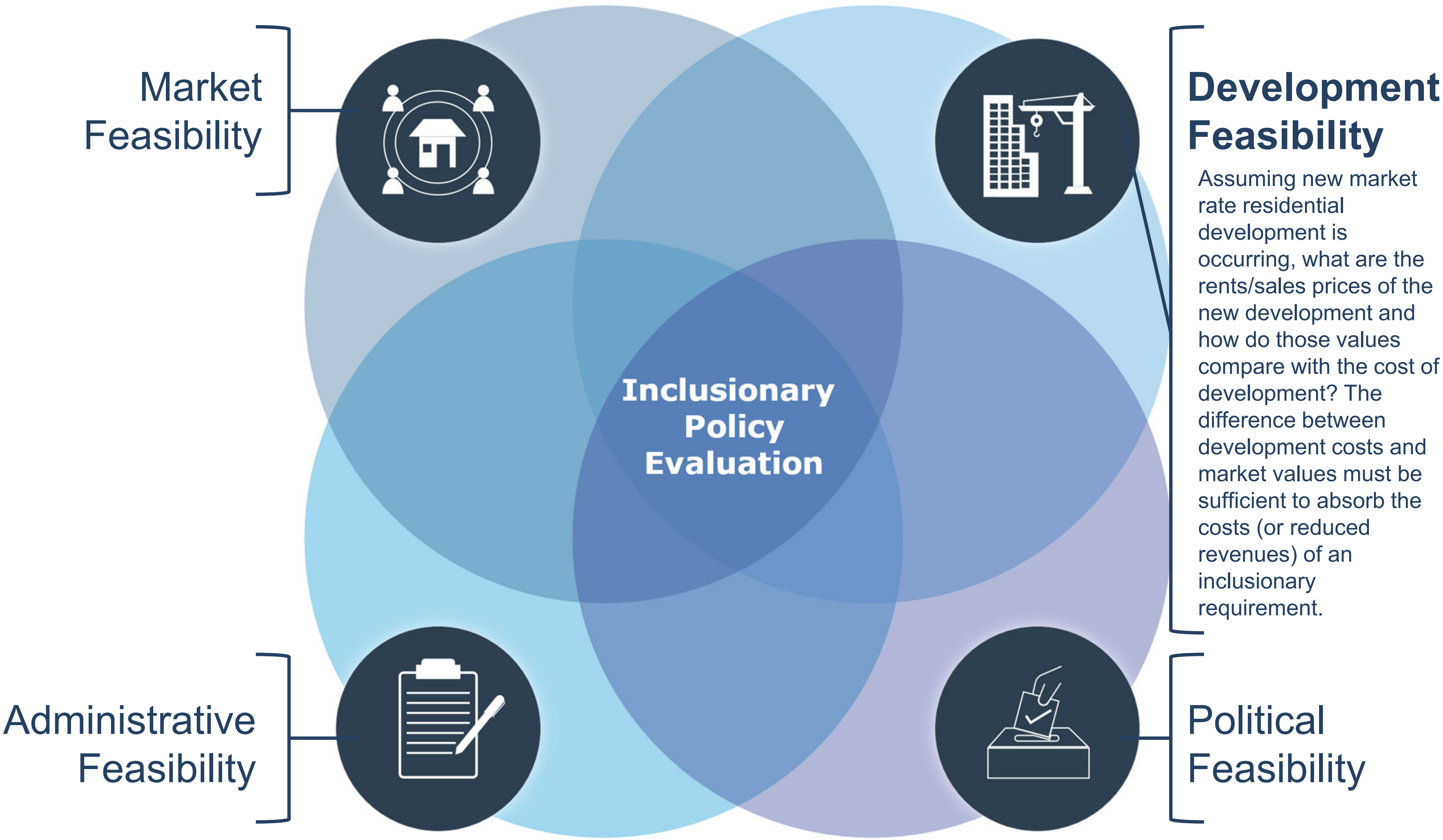


Administrative Feasibility

Political Feasibility

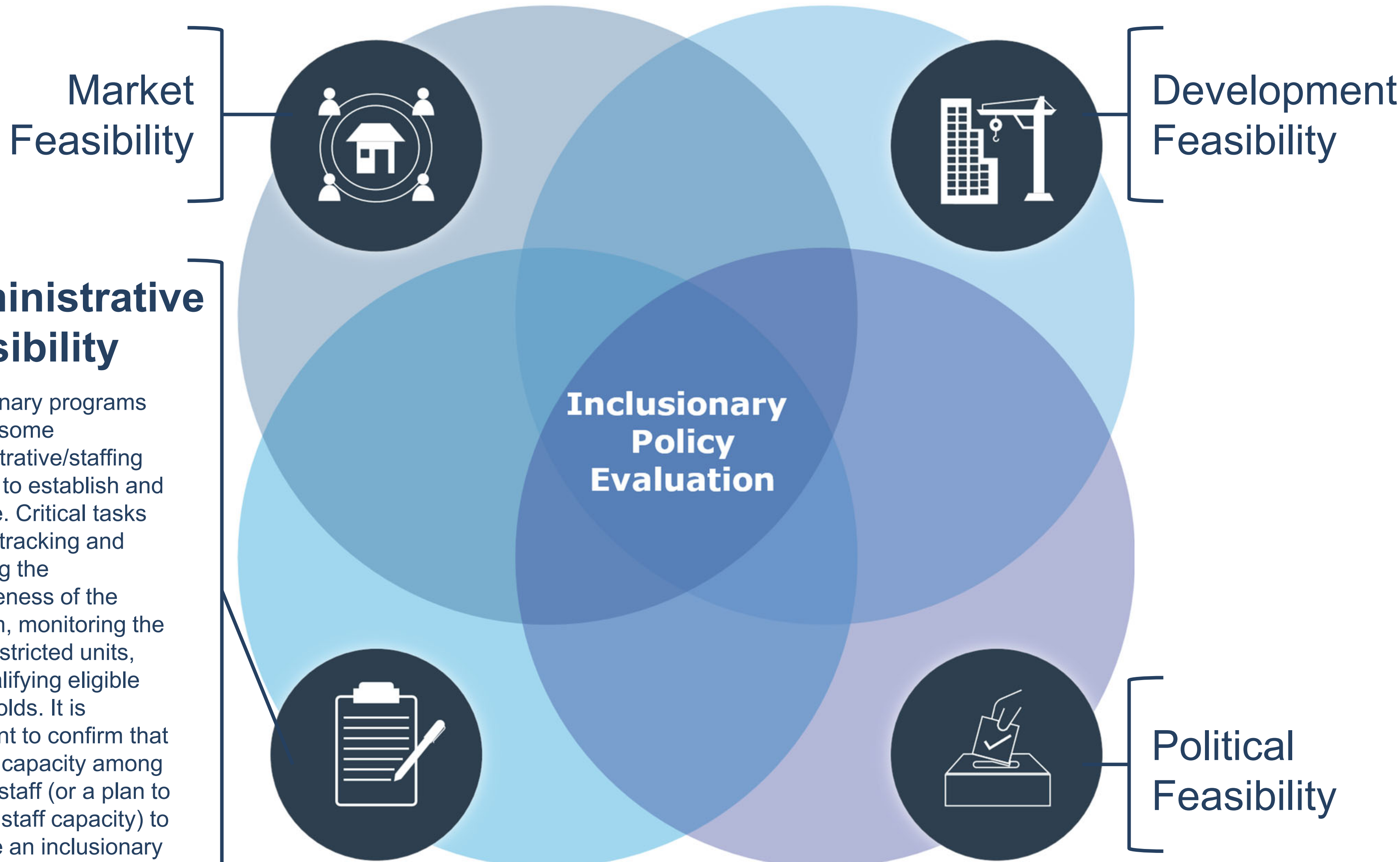
WHAT IS NEEDED FOR INCLUSIONARY TO WORK?

San Joaquin Valley



WHAT IS NEEDED FOR INCLUSIONARY TO WORK?

San Joaquin Valley

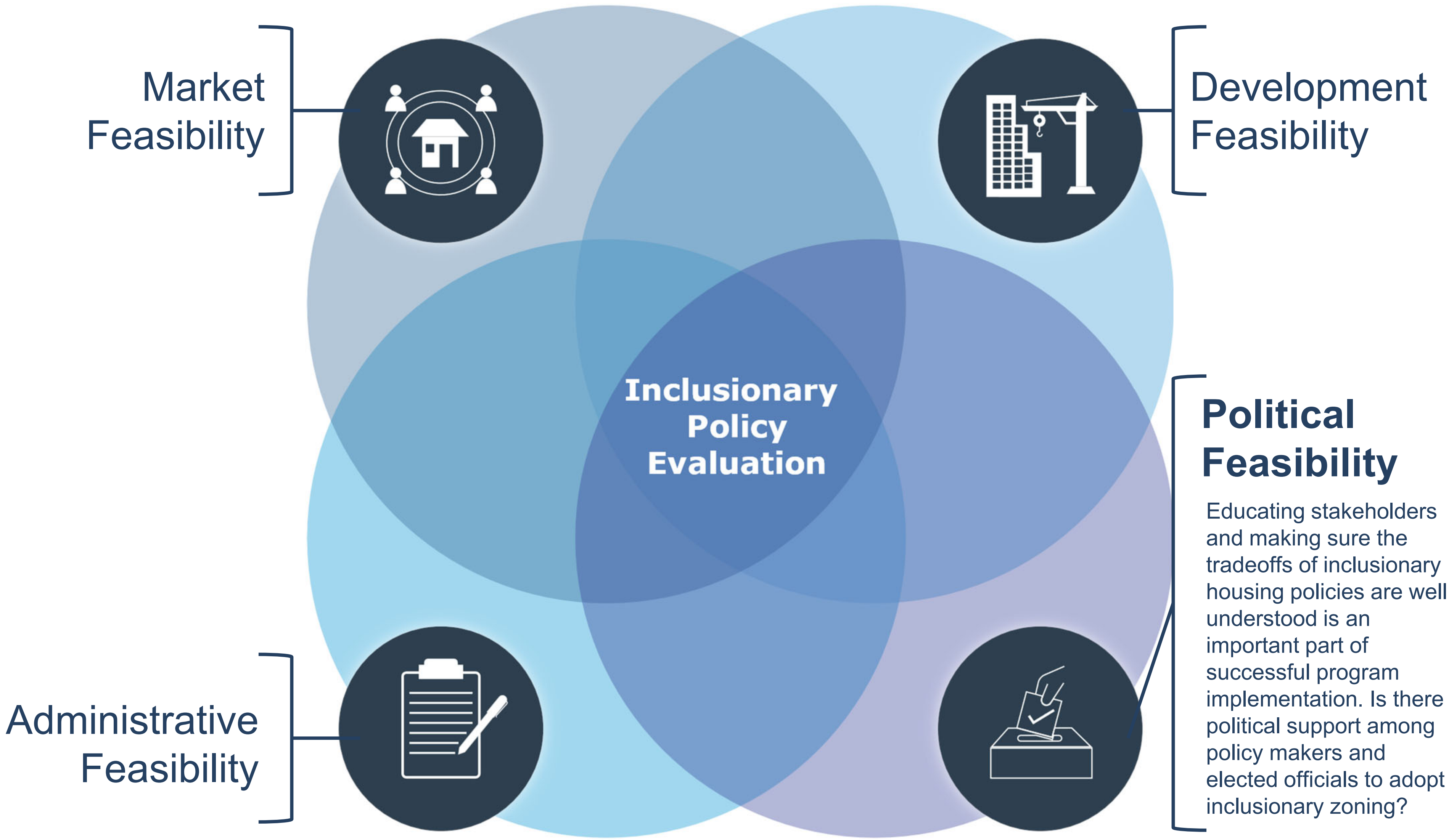


Administrative Feasibility

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.

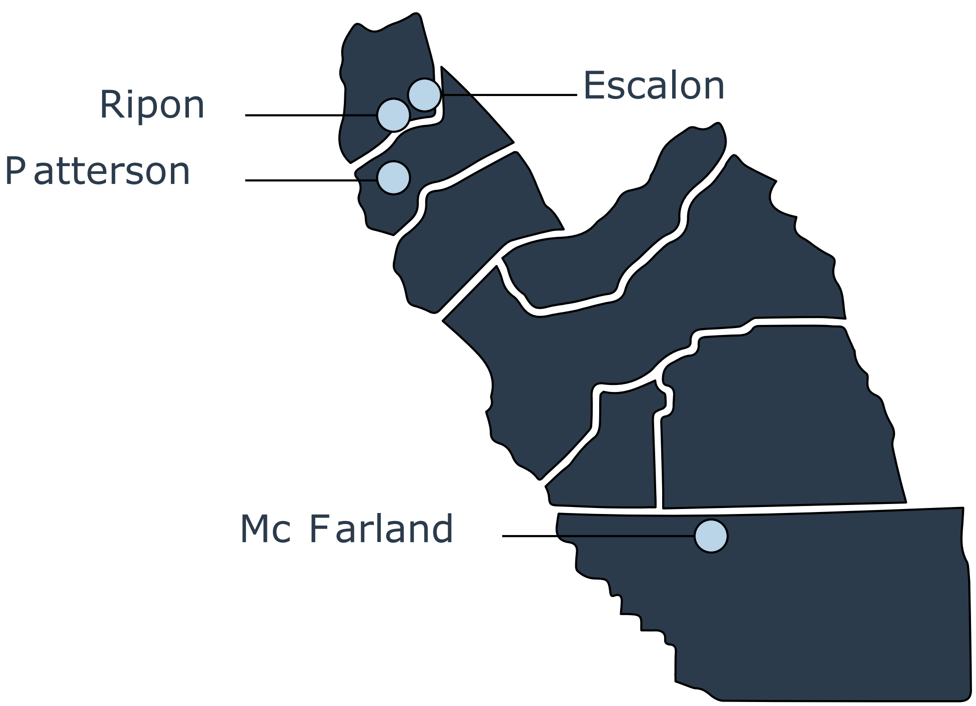
WHAT IS NEEDED FOR INCLUSIONARY TO WORK?

San Joaquin Valley



INCLUSIONARY PROGRAMS IN THE VALLEY

What are the impacts in Valley communities that have inclusionary policies?



- Four cities have active inclusionary housing ordinances: Ripon, McFarland, Patterson, and Escalon.
- Each of the four jurisdictions has a nuanced approach to its programs' key parameters.
- Programs are generating very few inclusionary units from market-rate development and not generating revenue from in-lieu fee programs.
- Slow pace of market-rate development is the biggest limiting factor.
- Some active inclusionary programs may be an artifact of a previous period of high market-rate activity (and lower development costs) and may not reflect current market conditions or a jurisdiction's current priorities.
- Periodically recalibrating an inclusionary program is critical to ensuring the program reflects current market and economic dynamics.

INCLUSIONARY PROGRAMS IN THE VALLEY

Escalon

- Ownership Requirement: 10-15% Very Low, Lower, and Moderate (to be constructed in equal numbers)
- Rental Requirement: 10-15% Very Low, Lower, and Moderate (to be constructed in equal numbers)
- Only 19 units were constructed between 2018 and 2021, all of which were market-rate. With a threshold size of five units or greater, it is possible that none of the market rate development was large enough to trigger the inclusionary requirement.

McFarland

- Ownership Requirement: At least 20% Very Low, Low, or Moderate
- Rental Requirement: At least 15% Very Low or Lower
- According to City Staff, all housing has been affordable before and after the implementation of its inclusionary program in 2005.

INCLUSIONARY PROGRAMS IN THE VALLEY

Patterson

- Ownership Requirement: At least 15% overall (9% Moderate and 6% Low)
- Rental Requirement: At least 15% overall (9% Low and 6% Very Low)
- Patterson's inclusionary housing program has not delivered any affordable units, as all housing built over the program's life was approved before its implementation.

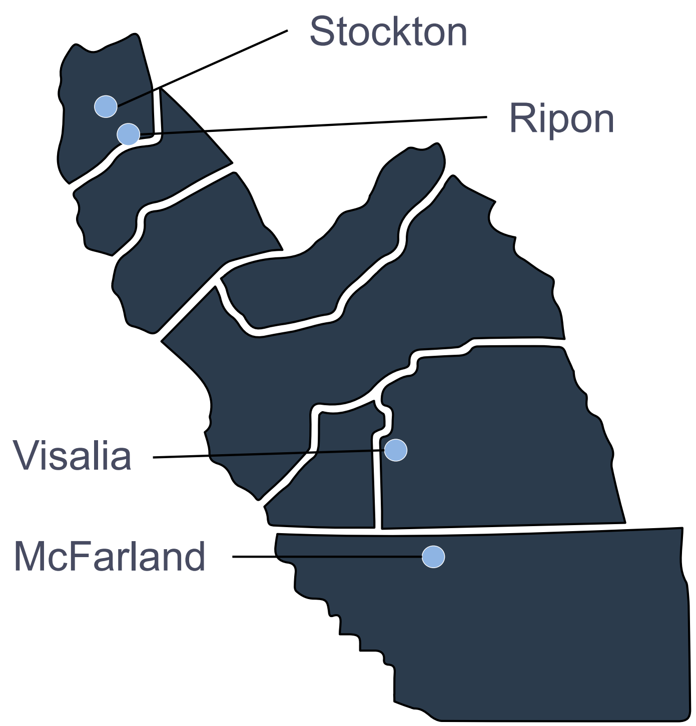
Ripon

- Ownership Requirement: 10% BMR Plus, or 3.75% Moderate and 1.25% Low
- Ripon's inclusionary program has produced 12 inclusionary units since 2018 under the BMR Plus development option which provides ownership opportunities for middle-income households.

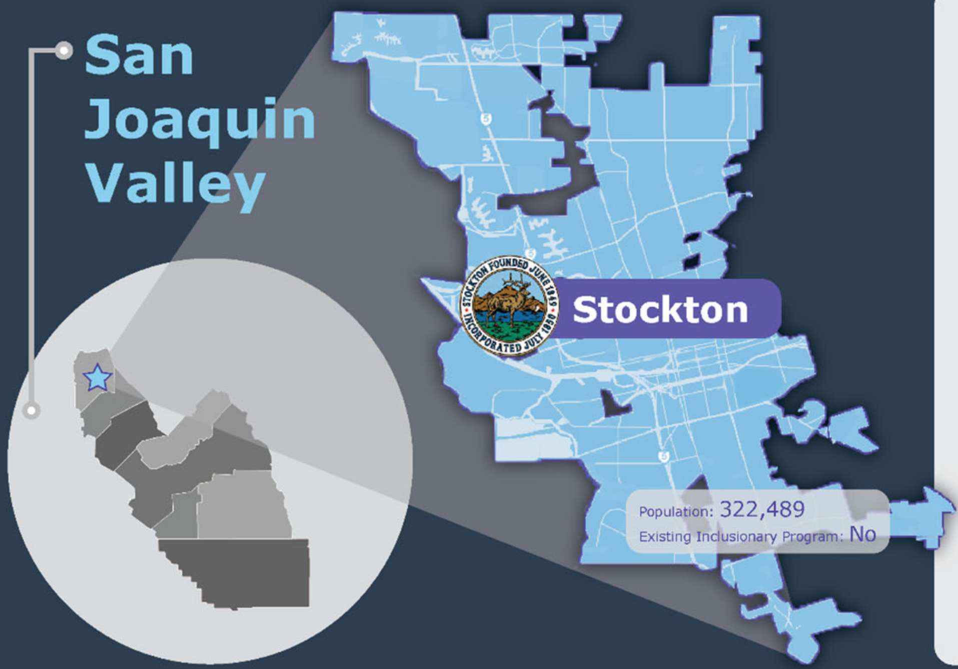
CASE STUDY ANALYSIS

What are the best types of inclusionary policies and alternatives that could "work" in the Valley?

- EPS studied four cities with the goal of capturing the diversity of the Valley: Stockton, Ripon, Visalia, and McFarland.
- Two of the four cities already have adopted inclusionary programs and two do not.
- Case study jurisdictions were selected to exhibit diverse outcomes and to underscore that inclusionary policies are not the right solution for every community.



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 $2,024.**

Affordable Housing Trends

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

- The affordable units produced in Stockton are largely built as 100% affordable, grant-funded projects, primarily with Low-Income Housing Tax Credit (LIHTC) program 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

The City of Stockton, like many other agencies, is experiencing significant workload and staffing shortages. Given the administrative requirements needed to adopt and implement an inclusionary housing program, administrative capacity constraints would make it challenging to implement 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 Building Industry Association (BIA) in particular maintains a strong presence in Stockton and has expressed concerns about increased development costs. That said, the City is committed to exploring a range of approaches and funding options to increase housing choice and affordability and will to continue to explore these options as part of its Housing Element Update and new Housing Action Plan that are currently being developed.

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.

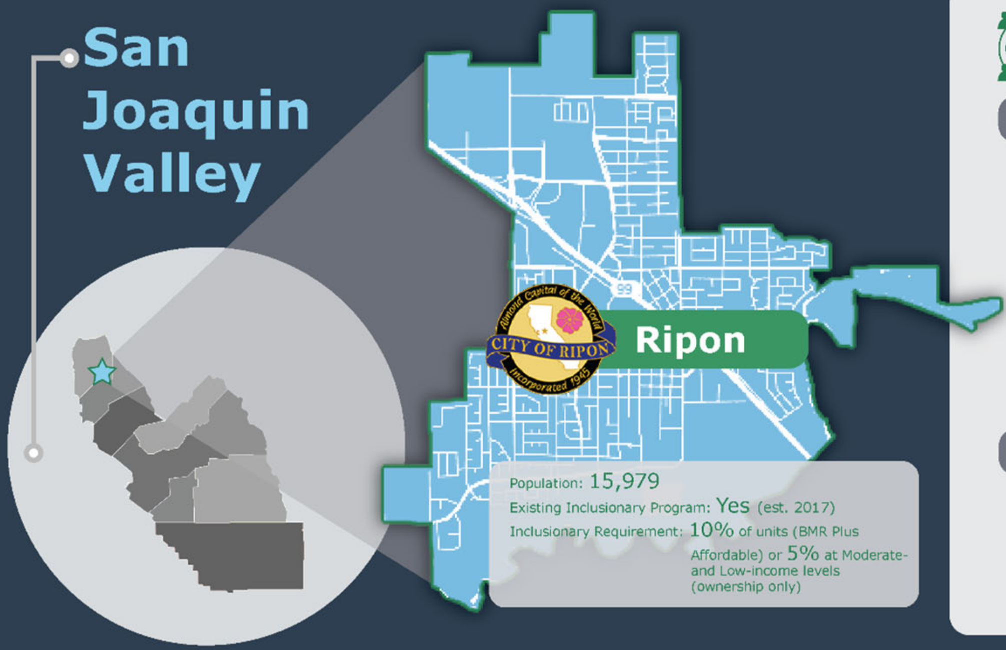
- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $316,501
- Per unit net operating income: $18,688
- Profit metric: 5.9% yield-on-cost (annual net operating income as a percentage of development costs); threshold for feasibility is assumed to be 5.5%.

Lessons Learned and Implications

- Market-rate pricing (sales prices and rents) of newly-constructed product suggests that, on average, new multifamily development may 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.

*Sales prices reflect an observed premium on new construction based on city-level data.
**Rents reflect an estimated premium on new construction in the region due to the lack of city-level data.
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



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.

*Sales prices reflect an observed premium on new construction based on city-level data.
**Rents reflect an estimated premium on new construction in the region due to the lack of city-level data.
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.

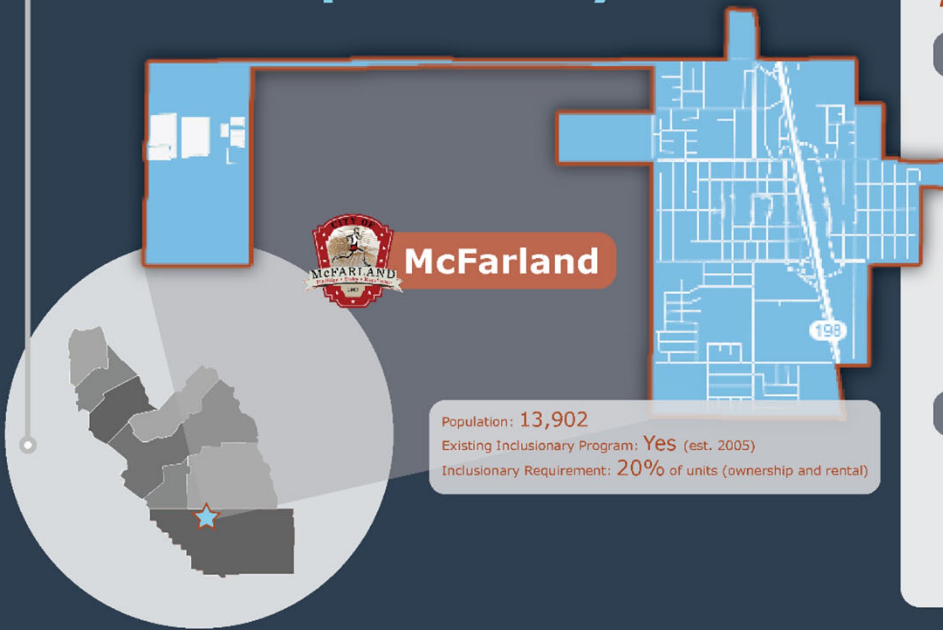
- Prototype: 30 units/acre, 1,000 sq.ft., 2 bedrooms
- Per unit development cost: $309,834
- Per unit net operating income: $18,519
- Profit metric: 6% yield-on-cost (annual net operating income as a percent-age of development costs); threshold for feasibility is assumed to be 5.5%.

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.

*Sales prices reflect an observed premium on new construction based on city-level data.
**Rents reflect an estimated premium on new construction in the region due to the lack of city-level data.
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.
- 9% 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.

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.

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%.

*Sales prices reflect an estimated premium on new construction in the region due to the lack of city-level data.
**Rents reflect an estimated premium on new construction in Kern County due to the lack of city-level data.
Sources: CA HCD; City of McFarland; CoreLogic Marshall & Swift; CoStar Group; Developer Interviews; LIHTC program applications; Redfin; Analysis by Economic & Planning Systems, Inc.

WHERE AND HOW CAN INCLUSIONARY WORK?

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?	[	✓	✓	[
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?	[	✓	✓	✓

Key

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

Analysis by Economic & Planning Systems, Inc.

LESSONS LEARNED

Which jurisdictions can benefit most from inclusionary policies?

- **Jurisdictions may be able to support an inclusionary program if:**
  - Market-rate development is occurring at a significant scale
  - Market-rate values exceed the cost of new development by a substantial margin
    - e.g., in locations experiencing high market demand and price pressures, such as San Joaquin County and Northeast Fresno/Clovis
- **Jurisdictions likely cannot support an inclusionary program if:**
  - Market-rate development is occurring at low levels
  - Market-rate pricing is low relative to development costs (or less than development costs)

ILLUSTRATIVE EXAMPLE: POTENTIAL IMPACT OF IMPLEMENTATION

EPS estimates between 439 and 3,950 affordable units could be created in the Valley through inclusionary programs **IF**

- 10-30% of the Valley's Above Moderate RHNA is developed in jurisdictions that have or adopt new inclusionary programs
- 75% of those Above Moderate units are in projects subject to inclusionary requirements (above the project size threshold, often 5 or 10 units and higher)
- The applicable inclusionary requirement ranges between 5 to 15%

% of Units in Valley Jurisdictions with Inclusionary Programs	Above-Moderate Units Impacted	Units in Projects Meeting Threshold Size [1]	Potential Range of Inclusionary Requirements		
			5%	10%	15%
10%	11,705	8,779	439	878	1,317
20%	23,410	17,557	878	1,756	2,634
30%	35,114	26,336	1,317	2,634	3,950

Note: The Valleywide 6th Cycle RHNA is 280,517 units (117,048 Above Moderate-Income Units, 46,991 Moderate-Income Units, and 116,478 Lower-Income Units).

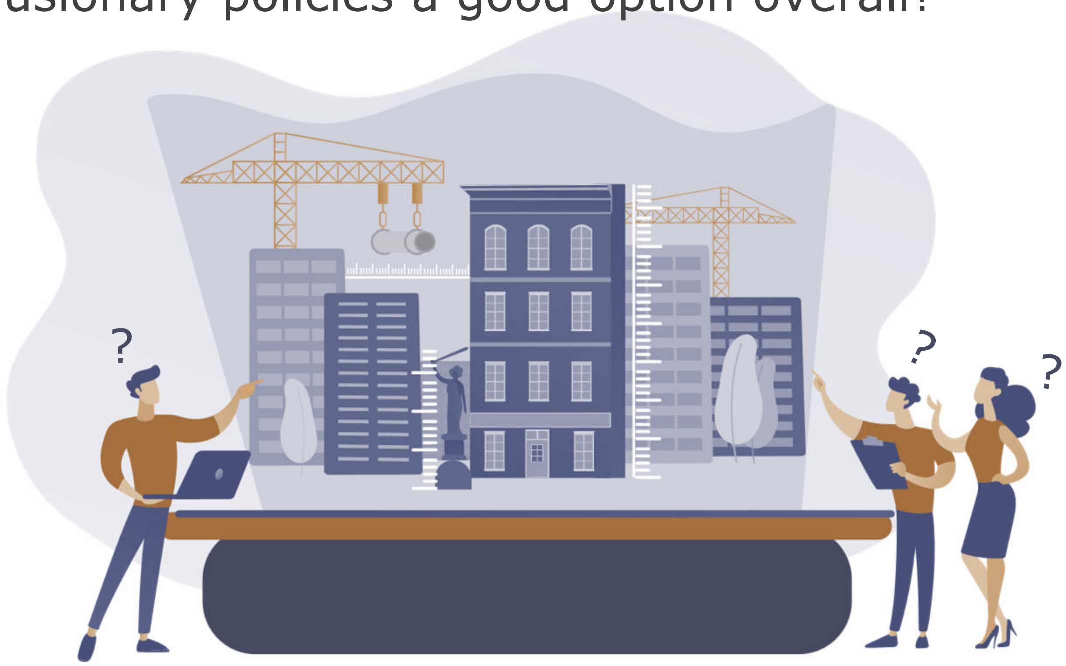
[1] Illustrative analysis assumes 25% of units developed in jurisdictions with inclusionary programs would not meet the size threshold, which typically applies to developments of more than 5 units.

Source: CA Dept. of Housing and Community Development; Analysis by Economic & Planning Systems, Inc.

BEST PRACTICES AND RECOMMENDATIONS

The following slides will answer three key questions:

1. How can inclusionary policies be implemented in a manner that addresses community concerns regarding affordable housing, builder concerns of cost, local political implications?
2. What can CA HCD and Valley COGs do to implement programs to further inclusionary zoning policy adoption?
3. Are inclusionary policies a good option overall?



RECOMMENDATIONS FOR JURISDICTIONS

Educate stakeholders and elected officials about the role inclusionary housing programs can play in achieving more affordable housing to establish political support

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) or for certain types of development that demonstrate feasibility

Consider adopting a program with an in-lieu fee that is lower than the equivalent of providing units on-site, as a means of generating revenue to support affordable housing production

RECOMMENDATIONS FOR COGS

- Monitor residential production trends, development costs, and market prices/rents in member jurisdictions
- Monitor the effectiveness of the inclusionary programs that are already in place in the member jurisdictions
- Continue to promote the research and resources that are available and offer education/training to jurisdictions
- Develop education/training available to member jurisdictions to reinforce that the State Density Bonus is an incentive-based tool

RECOMMENDATIONS FOR HCD

Prepare a Template for Economic Feasibility Studies. 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.

Recognize that households earning "Above Moderate" income at the County level may also need support. 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.

Pool regional RHNA credits. 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.

THANK YOU

QUESTIONS AND DISCUSSION