

MEMORANDUM

Date: DRAFT October 25, 2023

To: Omar Dadabhoy, Deputy City Manager/Community Development Director
City of Fountain Valley

From: Colin Druker, Principal
Steve Gunnells, Chief Economist

Subject: Inclusionary Housing In-Lieu Fee Recommendation

Summary

This memo recommends the amount for an in-lieu fee for the inclusionary housing requirement. It recommends an in-lieu fee in the amount of \$44,542 per new market-rate unit or \$296,950 per affordable unit required, and recommends text for a resolution to set the amount of the in-lieu fee.

Summary	1
Analysis	2
1. Introduction	2
2. Methodology	2
3. Affordable Housing Gap Calculation	3
4. Fee Calculation.....	5
Recommendations	6
5. Resolution Establishing the Amount of The In-lieu Fee	6
Appendix	7

Analysis

1. INTRODUCTION

1A. Background

To ensure that new development in Fountain Valley generates sufficient affordable housing for the City to meet its obligations under the Regional Housing Needs Assessment and the City's adopted General Plan Housing Element, the City is considering amending its Development Code to include an inclusionary housing requirement. The City is required to allow at least one method of compliance as an alternative to the developer providing the required number of affordable units on the same site as a new residential development project. One of the alternative methods of compliance that is being considered is the option to pay a fee in-lieu of constructing inclusionary housing units.

The purpose of this memo is to provide a methodology for calculating the in-lieu fee and to recommend the amount of the fee.

2. METHODOLOGY

2A. General Approach

The general approach is to determine the typical cost for the City to have an affordable housing unit built. The in-lieu fee would then be set at a level that would generate sufficient revenue to have the required number of affordable units built.

2A(i) Example

Take, for example, a hypothetical residential subdivision that would have 100 lots. The inclusionary housing provisions would require that 15 of the units (15 percent of the total) be below-market-rate units (BMR) that are restricted to low-income households. The remaining 85 units would be sold at market rate (MR) prices¹.

If, instead of a mixed-income development project (i.e., 15 BMR and 85 MR units), the developer chose the alternative of paying an in-lieu fee, the proposed project would have 100 MR units, and the total amount of in-lieu fees paid should be sufficient to have 15 affordable housing units constructed elsewhere in Fountain Valley.

If that cost were \$200,000 per affordable unit, then the in-lieu fee for the project should be at least \$3 million (15 BMR units X \$200,000 per unit = \$3 million). Because the developer's proposed project has 100 MR houses, the in-lieu fee, on a per unit basis, would be \$30,000 (\$3 million total ÷ 100 MR units = \$30,000 per unit).

¹ Under the state's Density Bonus Law, a developer providing affordable housing units as part of a mixed-income residential development could also be eligible for a density bonus, which would permit the developer to construct additional market rate units. However, a developer choosing to pay a fee in-lieu of constructing affordable units is not eligible for a density bonus. For simplicity, the issue of density bonus units is omitted because it does not affect the in-lieu fee.

2B. Affordable Housing Development Finance

Most affordable housing is constructed and operated by specialized affordable housing developers. They have expertise in accessing a variety of funding sources, and they have expertise in qualifying income-eligible households. The recommended fee derived in subsequent sections is based on six Orange County affordable housing projects that the state awarded tax credits in 2021 and 2022. Details on these projects are provided in the Appendix in Tables A-1 through A-6.

There are three important types of funding for the permanent financing of affordable housing developments. First and foremost are Low-Income Housing Tax Credits (LIHTC). These are tax credits that the federal government annually provides to states to distribute to affordable housing development projects. In California, the Tax Credit Allocation Committee awards tax credits on a competitive basis annually. Affordable housing developers have indicated that it is not uncommon for an application to take up to three rounds before being successful. However, they have also indicated that they are rather confident in their ability to eventually receive tax credit funding for projects.² As shown in Table A-4, in the six Orange County affordable housing projects, tax credits accounted for 33 percent to 54 percent of the total permanent financing.

Affordable housing projects also rely on conventional bank financing for permanent funding, just as market rate developers do. Residents of affordable housing projects pay rent—albeit a reduced rent that is affordable. These rent payments cover the operation and maintenance expenses. The amount of rent in excess of operation and maintenance costs is used to repay the conventional bank financing.

Finally, there are all the other sources of funding. Part of the art of affordable housing development is being able to piece together a variety of other funding sources to fully fund a development. Part of the challenge is timing these other sources to coincide with the awarding of tax credit funding.

2C. Fee Basis

Affordable housing developers have indicated their confidence in obtaining tax credits and conventional bank financing. If funding from in-lieu fees can make up the difference from all the other funding sources they usually piece together, they should be able to develop affordable housing in Fountain Valley. Thus, the basis for the in-lieu fee is the gap between the development cost and the tax credit funds plus bank financing. This amount is calculated below.

3. AFFORDABLE HOUSING GAP CALCULATION

3A. Average Development Cost

Table A-5 in the Appendix provides a breakdown of the development costs for each of the six Orange County affordable housing projects, adjusted for inflation into June 2023 dollars. Generally, construction costs for affordable housing projects can be expected to be similar across Orange County jurisdictions, with the exception of the cost to acquire land. To calculate the affordable housing gap, the analysis separates

² There are two types of LIHTC, commonly referred to as 4 percent credits and 9 percent credits. The affordable housing developers interviewed for this report say that the 9 percent credits are very challenging to get but that they are confident that they can obtain 4 percent tax credits for affordable housing projects. References to tax credits in this report refer to the 4 percent tax credits, and the permanent financing data in Table A-4 and Table A-6 are for 4 percent tax credits.

out the land cost and substitutes a Fountain Valley-specific estimate of the cost to acquire land for affordable housing development.

Table 1, below, provides the total development cost less the land acquisition cost for the six Orange County affordable housing projects combined, the total number of affordable dwelling units across the six projects, and the resulting weighted average development cost, excluding land, per affordable residential unit. The data indicated that, on average, each unit of affordable housing costs \$478,000 plus the cost to acquire land.

Table 1: Weighted Average Development Cost per Unit, Excluding Land, in Inflation Adjusted June 2023 Dollars for Six Recent Affordable Housing Projects; Orange County; 2021 and 2022

Total Development Cost	\$251,475,024
Less Land Acquisition Cost	\$28,328,414
Development Cost, ex. Land	\$223,146,610
Total Number of Affordable Units	467
Average Development Cost per Unit, ex. Land	\$477,830

Source: PlaceWorks 2023, using cost data from the CA Tax Credit Allocation Committee and inflation-adjustment data based on the US Bureau of Labor Statistics, Consumer Price Index, All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U).

3B. Estimated Land Acquisition Cost

There is little vacant land in Fountain Valley and even less vacant land that is actively sold. Thus, estimating the cost to acquire land for affordable housing development is challenging. However, the analysis identified four property sales since 2018. These sites ranged from 1.96 acres (the Prada affordable housing development) to 18.64 acres (the Miller property). The data are provided in Table A-7. After adjusting for inflation, the weighted average price is \$3.59 million per acre.

The six Orange County affordable housing projects provided a total of 467 affordable housing units across a total of 25.03 acres, which results in a weighted average density of 18.66 affordable housing units per acre. With an average price of \$3.59 million per acre, the estimated land cost per unit is \$192,343 (\$3.58 million per acre ÷ 18.66 units per acre).

3C. Average Project Financing

Table A-6 in the Appendix provides a breakdown of the funding sources used for permanent financing of the six Orange County affordable housing projects, adjusted for inflation into June 2023 dollars. Table 2, below, shows the total permanent bank financing and the total federal tax credit equity as well as the weighted average per unit. The data indicate that, on average, the typical affordable housing unit is funded with \$154,500 in conventional bank financing and \$219,000 in federal tax credits.

Table 2: Weighted Average Bank Financing and Federal Tax Equity per Unit in Inflation Adjusted June 2023 Dollars for Six Affordable Housing Projects; Orange County; 2021 and 2022

Total Number of Units	467
Total Permanent Bank Financing	\$72,140,422
Average Bank Financing per Unit	\$154,476
Total 4% Federal Tax Credit Equity	\$102,154,813
Average Tax Credit Equity per Unit	\$218,747

Source: PlaceWorks 2023, using funding data from the CA Tax Credit Allocation Committee, and inflation-adjustment data based on the US Bureau of Labor Statistics, Consumer Price Index, All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U).

3D. Affordable Housing Financing Gap

The affordable housing financing gap—which is the amount that the inclusionary housing in-lieu fee would cover—is the difference between the development cost and the two types of permanent financing that affordable housing developers can reliably access. As shown in Table 3, the analysis estimates the average affordable housing financing gap per unit in Orange County, in June 2023 dollars, at \$297,000.

Table 3: Average Affordable Housing Financing Gap per Unit in Inflation Adjusted June 2023 Dollars for Recent Six Affordable Housing Projects; Orange County; 202a and 2022

Construction Cost per Unit (ex. Land)	\$477,830
Land Cost per Unit	\$192,343
Less Bank Financing	-\$218,747
Less Federal 4% Tax Credit Equity	-\$154,476
Required Subsidy per Unit	\$296,950

Source: PlaceWorks 2023, using cost and funding data from the CA Tax Credit Allocation Committee, and inflation-adjustment data based on the US Bureau of Labor Statistics, Consumer Price Index, All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U).

4. FEE CALCULATION

The City could adopt a fee of \$296,950 per affordable housing unit that is required under the inclusionary housing provisions in the Zoning Ordinance when the developer chooses to forego construction of those units. However, to facilitate an easy application of the in-lieu fee, the City may consider structuring the fee based on the number of proposed market rate units.

4A. Fee per Unit

The City is considering a development code amendment that requires 15 percent inclusionary housing. This means that for each group of 20 new dwelling units, there would be 3 affordable units and 17 market rate units. If the developer chooses not to build the affordable units, then all 20 units would be market rate, and the in-lieu fee across all 20 units would need to add up to the affordable housing

financing gap for three affordable dwellings, of \$890,849 (\$296,950 per affordable unit X 3 affordable units). This works out to an in-lieu fee of \$44,542 per market rate unit (\$890,849 total affordable housing gap for 3 affordable units ÷ 20 market rate units).

Recommendations

5. RESOLUTION ESTABLISHING THE AMOUNT OF THE IN-LIEU FEE

In conjunction with the adoption of the Development Code amendment, the City Council should adopt a resolution establishing the amount of the in-lieu fee. The resolution should state:

Pursuant to Development Code Section (*insert section number authorizing an in-lieu fee*), the inclusionary housing in-lieu fee is hereby established in the amount of \$44,542 per new residential dwelling unit.

On July 1 of each calendar year, the amount of the in-lieu fee shall be increased based on the increase in the US Bureau of Labor Statistics' Consumer Price Index. All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U), unless changed by resolution of the City Council.

Appendix

Table A-1: Project Descriptions for Recent Affordable Housing Projects; Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
PROJECT DESCRIPTION						
# of Residential Buildings	2	8	2	1	1	1
# of Units	85	144	62	58	65	60
# of Tax Credit Units	84	142	61	57	64	59
Housing Type	Non-Targeted	Large Family	Large Family	Non-Targeted	Seniors	Large Family
Unit Mix						
1-Bedroom	23	40		17	52	15
2-Bedroom	4	64	18	40	13	17
3-Bedroom	34	40	44	1		28
4-Bedroom	24					
Affordability Mix						
At or below 30% AMI	63	15			9	10
At or below 40% AMI						
At or below 50% AMI		93			37	10
At or below 60% AMI	21	35			18	18
At or below 70% AMI						8
At or below 80% AMI						13

Source: PlaceWorks 2023, using data from the CA Tax Credit Allocation Committee.

Table A-2: Project Cost Summary for Recent Affordable Housing Projects; Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
TOTAL PROJECT COST						
Land and Acquisition	7,401,288	3,521,000	4,321,000	18,559	2,785,000	8,121,174
Construction Costs	29,107,442	42,417,022	16,645,802	10,207,108	14,855,714	18,635,921
Rehabilitation Costs	0	0	0	0	0	0
Construction Contingency	1,475,372	2,123,401	1,654,493	1,076,424	742,786	1,925,692
Soft Cost Contingency	100,000	198,794	300,000	307,613	300,000	390,589
Relocation	0	0	0	0	0	0
Architectural/Engineering	865,000	2,337,500	1,175,000	877,387	1,020,000	1,375,000
Const. Interest, Permanent Financing	1,705,335	2,973,000	1,649,232	1,613,489	2,005,766	3,459,980
Legal Fees	187,500	350,000	160,000	0	148,000	162,500
Reserves	1,302,160	468,422	283,800	267,747	198,600	297,200
Other Costs	2,142,944	5,062,463	2,235,179	1,399,374	2,806,900	3,243,897
Developer Fee	2,525,000	4,400,000	3,463,825	1,953,655	3,176,902	4,213,730
Total	46,812,041	63,851,602	31,888,331	21,794,074	28,039,668	41,825,683
PER AFFORDABLE UNIT COSTS						
Construction Cost per Sq. Ft.	297	314	234	230	232	240
Per Unit Cost	550,730	443,414	514,328	300,943	431,380	697,095
True Cash Per Unit Costs	550,730	406,192	450,395	300,943	397,889	655,199

Source: PlaceWorks 2023, using data from the CA Tax Credit Allocation Committee.

Table A-3: Construction Finance Summary for Recent Affordable Housing Projects; Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
TOTAL PROJECT COST						
Bank Financing	12,145,497	8,242,790	2,400,200	4,307,355	3,304,626	1,491,406
Bank Financing (Tax Exempt)	23,990,343	32,110,131	16,100,000	11,245,815	14,900,000	21,000,000
City	3,513,907	0	1,600,000	0	0	9,450,000
County Housing	1,450,349	0	0	0	0	0
Deferred Costs	2,322,638	3,677,422	3,039,768	1,062,177	3,181,742	3,786,378
State	0	0	1,250,000	0	0	1,574,810
Other	0	100	3,000,000	3,732,585	100	100
Other	0	18,253,102	762,500	953,655	2,760,000	0
Other	0	0	100	100	0	0
Tax Credit Equity	3,389,307	2,835,594	3,735,763	492,387	3,893,200	4,522,989
Total	46,812,041	65,119,139	31,888,331	21,794,074	28,039,668	41,825,683

Source: PlaceWorks 2023, using data from the CA Tax Credit Allocation Committee.

Table A-4: Permanent Finance Summary for Recent Affordable Housing Projects; Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
TOTAL PROJECT COST						
Bank Financing	12,915,001	16,610,000	11,836,390	5,499,000	6,772,550	12,309,880
City	3,904,341	0	1,600,000	0	0	9,450,000
County Housing	4,258,280	0	0	0	1,192,320	0
County Other	1,450,349	0	479,520	0	0	567,000
State	7,312,537	0	1,250,000	0	0	1,574,810
State	0	0	0	0	0	0
Deferred Developer Fee	25,000	1,900,000	963,825	122,912	2,176,902	2,583,598
Tax Credit Equity	16,946,533	27,088,400	11,995,996	7,146,442	15,137,796	15,340,295
General Partner Equity and Contribution	0	100	100	3,732,585	100	100
Other	0	18,253,102	762,500	4,339,380	2,760,000	0
Other	0	0	3,000,000	953,755	0	0
Total	46,812,041	63,851,602	31,888,331	20,840,319	28,039,668	41,825,683
- Tax Credit Equity % of Total	36%	42%	38%	34%	54%	37%

Source: PlaceWorks 2023, using data from the CA Tax Credit Allocation Committee.

Table A-5: Project Cost Summary for Recent Affordable Housing Projects, Adjusted for Inflation (June 2023 Dollars); Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
Inflation Adjustment	1.120	1.120	1.120	1.120	1.030	1.030
TOTAL PROJECT COST						
Land and Acquisition	8,288,986	3,943,303	4,839,253	20,785	2,869,247	8,366,841
Construction Costs	32,598,538	47,504,447	18,642,271	11,431,331	15,305,101	19,199,660
Rehabilitation Costs	0	0	0	0	0	0
Construction Contingency	1,652,326	2,378,078	1,852,930	1,205,528	765,255	1,983,944
Soft Cost Contingency	111,994	222,637	335,981	344,508	309,075	402,404
Relocation	0	0	0	0	0	0
Architectural/Engineering	968,747	2,617,856	1,315,927	982,619	1,050,855	1,416,594
Const. Interest, Permanent Financing	1,909,870	3,329,576	1,847,038	1,807,008	2,066,441	3,564,645
Legal Fees	209,988	391,978	179,190	0	152,477	167,416
Reserves	1,458,339	524,604	317,838	299,860	204,608	306,190
Other Costs	2,399,965	5,669,646	2,503,263	1,567,213	2,891,809	3,342,025
Developer Fee	2,827,844	4,927,728	3,879,270	2,187,973	3,273,004	4,341,196
Total	52,426,597	71,509,853	35,712,962	19,846,825	28,887,872	43,090,915
PER AFFORDABLE UNIT COSTS						
Construction Cost per Sq. Ft.	297	314	234	230	232	240
Per Unit Cost	550,730	443,414	514,328	300,943	431,380	697,095
True Cash Per Unit Costs	550,730	406,192	450,395	300,943	397,889	655,199

Source: PlaceWorks 2023, using cost summary data from the CA Tax Credit Allocation Committee and inflation-adjustment data based on the US Bureau of Labor Statistics, Consumer Price Index, All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U).

Table A-6: Permanent Finance Summary for Recent Affordable Housing Projects, Adjusted for Inflation (June 2023 Dollars); Orange County; 2021 and 2022

Project Number	CA-21-756	CA-21-757	CA-21-615	CA-21-647	CA-22-464	CA-22-553
Project Name	Westview House	Lynx Family Housing	Orange Corporate Yard	Portola Senior	The Meadows Seniors Apartments	Cartwright Family Apartments
Site Address	2530 & 2534 Westminster Ave Santa Ana, CA 92706	Lynx Street and Astor Street Irvine, CA 92618	637 West Struck Avenue Orange CA 92867	SE Corner Glen Ranch and Saddleback Ranch Roads Lake Forest CA 92679	20621 Lake Forest Drive Lake Forest, CA 92630	17861 Cartwright Road Irvine, CA 92614
Inflation Adjustment	1.120	1.120	1.120	1.120	1.030	1.030
TOTAL PROJECT COST						
Bank Financing	14,464,004	18,602,175	13,256,026	6,158,541	6,977,421	12,682,255
City	4,372,621	0	1,791,901	0	0	9,735,864
County Housing	4,769,011	0	0	0	1,228,388	0
County Other	1,624,301	0	537,033	0	0	584,152
State	8,189,590	0	1,399,923	0	0	1,622,448
State	0	0	0	0	0	0
Deferred Developer Fee	27,998	2,127,883	1,079,425	137,654	2,242,754	2,661,752
Tax Credit Equity	18,979,071	30,337,336	13,434,775	8,003,574	15,595,716	15,804,341
General Partner Equity and Contribution	0	112	112	4,180,265	103	103
Other	0	20,442,348	853,953	4,859,838	2,843,490	0
Other	0	0	3,359,815	1,068,147	0	0
Total	52,426,597	71,509,853	35,712,962	24,408,018	28,887,872	43,090,915
- Tax Credit Equity % of Total	36%	42%	38%	33%	54%	37%

Source: PlaceWorks 2023, using data from the CA Tax Credit Allocation Committee and inflation-adjustment data based on the US Bureau of Labor Statistics, Consumer Price Index, All items in U.S. city average, all urban consumers, chained, not seasonally adjusted (C-CPI-U).

Site	Sales Price Estimate	Inflation Adjusted Price	Area (acres)	Per unit Price (\$/acre)
Prado/Related	6,443,882	7,611,955	1.96	3,883,651
Slater 169-122-02	2,394,553	2,802,235	0.68	4,120,934
Slater 169-122-07	4,615,500	5,531,485	1.18	4,687,699
Slater 169-122-08	5,431,500	6,509,427	1.48	4,398,261
Miller Property	65,000,000	72,424,580	18.64	3,885,439
School Site	33,500,000	37,326,514	12.90	2,893,528
Total	-	132,206,196	36.84	-
Weighted Average	-	-	-	3,588,659