



CITY OF ATASCADERO CITY COUNCIL & PLANNING COMMISSION SPECIAL JOINT MEETING (STUDY SESSION) AGENDA

*** COVID-19 NOTICE ***

Consistent with the SLO County Region 1 – Southern California Regional Stay at Home Order, the City Council Meeting will not be physically open to the public and City Council Members will be teleconferencing into the meeting.

HOW TO OBSERVE THE MEETING:

To maximize public safety while still maintaining transparency and public access, the meeting will be available for public participation through the following link <https://us02web.zoom.us/j/85975868055?pwd=SUU3UUtWQzJQYXNPRklyRmJKY1FZQT09>

HOW TO SUBMIT PUBLIC COMMENT:

Members of the public are highly encouraged to use the link above or may call **(669) 900-6833** (Webinar ID: 859 7586 8055) to listen and provide public comment via phone. Written public comments may be submitted to cityclerk@atascadero.org by 5:00 pm on the day of the meeting. Such email **comments must identify the Study Session in the subject line of the email**. The comments will be read into the record, with a maximum allowance of 3 minutes per individual comment, subject to the Mayor's discretion. All comments should be a maximum of 500 words, which corresponds to approximately 3 minutes of speaking time. If a comment is received after the agenda item is heard but before the close of the meeting, the comment will still be included as a part of the record of the meeting but will not be read into the record.

AMERICAN DISABILITY ACT ACCOMMODATIONS:

Any member of the public who needs accommodations should contact the City Clerk's Office at cityclerk@atascadero.org or by calling 805-470-3400 at least 48 hours prior to the meeting or time when services are needed. The City will use their best efforts to provide reasonable accommodations to afford as much accessibility as possible while also maintaining public safety in accordance with the City procedure for resolving reasonable accommodation requests.

City Council agendas and minutes may be viewed on the City's website: www.atascadero.org.

Copies of the staff reports or other documentation relating to each item of business referred to on the Agenda are on file in the office of the City Clerk and are available for public inspection on our website, www.atascadero.org. Contracts, Resolutions and Ordinances will be allocated a number once they are approved by the City Council. The Minutes of this meeting will reflect these numbers. All documents submitted by the public during Council meetings that are either read into the record or referred to in their statement will be noted in the Minutes and available for review by contacting the City Clerk's office. All documents will be available for public inspection during City Hall business hours once City Hall is open to the public following the termination of the Shelter at Home Order.

SPECIAL JOINT MEETING

Atascadero City Council Atascadero Planning Commission

Thursday, March 11, 2021
6:00 P.M.

Atascadero City Hall Council Chambers, 4th Floor
6500 Palma Avenue, Atascadero, California
(TELECONFERENCE)

AGENDA

ROLL CALL:

DISCUSSION:

1. Inclusionary Housing Strategy Study Session

- Fiscal Impact: None.
- Recommendation: Council and Planning Commission discuss, and Council provide initial feedback to staff for the development of an inclusionary housing strategy. [Community Development]

ADJOURNMENT:

The City Council will adjourn to its next Regular Session on March 23, 2021; and the Planning Commission will adjourn to its next Regular Session on March 16, 2021.

STATE OF CALIFORNIA)
COUNTY OF SAN LUIS OBISPO)
CITY OF ATASCADERO)

AMANDA MUTHER, being fully sworn, deposes, and says: That she is the Deputy City Clerk of the City of Atascadero and that on March 3, 2021, she caused the above Notice to be posted at the Atascadero City Hall, 6500 Palma Avenue, Atascadero, California and was available for public review in the Customer Service Center at that location.

AMANDA MUTHER, Deputy City Clerk
City of Atascadero



Atascadero City Council

Management Report – Community Development Department

Inclusionary Housing Strategy Study Session

RECOMMENDATION:

Council and Planning Commission discuss, and Council provide initial feedback to staff for the development of an inclusionary housing strategy.

DISCUSSION:

Background

The City Council adopted an interim Inclusionary Housing Policy in 2003 that requires all housing projects that are subject to a legislative action (conditional use permit, subdivision map, rezoning) to provide affordable units or pay an in-lieu fee into the City's affordable housing fund. The City has been operating under this policy since adoption. Since that time, State Density Bonus law has substantially changed, and many housing projects have now become "by right" not allowing the City to perform discretionary review. An inclusionary (or affordable) housing ordinance could replace the policy and recognize more recent State updates, while implementing the City's General Plan Housing Element. With State requirements mandating specific housing goals for our Community, the adoption of an inclusionary housing program will ensure that the City can be successful in meeting the identified RHNA goals. An inclusionary program can help to ensure the physical construction of housing for all income categories, while helping to finance the City's ability to administer the affordable housing program.

The recently adopted Housing Element asks that the City explore adoption of an Inclusionary Housing program. At the November 12, 2019 Council meeting, the City Council authorized a contract with MIG to work with City staff and the Community to assist the City with drafting an Inclusionary Housing Strategy. MIG has prepared an overview memo detailing the current State regulatory framework, a summary of Atascadero's inclusionary policy, various affordable housing tools (and the benefits and constraints of each), case studies of surrounding jurisdiction's affordable housing requirements, and implementation ideas for Atascadero (Attachment 1).

The tools described in the memo include:

- Inclusionary housing ordinances
- Affordable housing impact fee/linkage fees
- Affordability by design

The adoption of an inclusionary housing ordinance is a required activity listed in the adopted 2021-2028 Housing Element. The City has received grant funding toward the development of this ordinance. Depending on scope and direction of the final program, grant funding may or may not cover the entire costs of implementation and adoption. The City has currently set aside approximately \$60,000 from the SB2 grant funds for this activity. Long term fiscal impacts as a result of a well-balanced inclusionary housing program can be positive. This is because the program should be designed to pay for staff costs associated with the administration of affordable housing, and the creation of affordable housing will help to meet State mandated RHNA numbers. Cities that meet or exceed RHNA numbers are eligible to receive infrastructure funding grants and other economic development related grants.

The purpose of this discussion is to hear community and City Council input regarding goals for affordable housing in Atascadero, discuss implementation options/tools, and provide direction to staff and the consultant related to the next steps in developing an affordable housing program that works for Atascadero.

FISCAL IMPACT:

None. Other than the use of budgeted staff time, there is no fiscal impact of the Council providing staff direction. Depending on the staff direction provided by the Council, implementation of the direction will result in the use SB2 grant funds for staff time and consultant costs.

ALTERNATIVES:

The City Council may recommend that staff not pursue development of an inclusionary housing strategy at this time. It is important to note that the adopted Housing Element that was certified by the State lists this activity for completion on or before December 2022.

ATTACHMENT:

MIG Inclusionary Housing Memo

City of Atascadero Housing Element Inclusionary Ordinance Options

I. Introduction and Background

Atascadero has long been committed to providing housing opportunities for all members of the community. In 2003, the City adopted an inclusionary housing policy requiring all developments that were subject to legislative approval (including zone changes, planned unit developments, and specific plans) to provide 20 percent of the units as affordable/deed restricted to households of very low, low, and moderate incomes or in specific circumstances, to provide in-lieu fees equal to 5% of building valuation. Under the existing policy, 147 units have been created (plus 22 in the pipeline), and over \$1.11 million in-lieu fees have been collected.

However, over the past 15+ years, market conditions have changed significantly, State laws related to affordable housing incentives have changed drastically, and much of the large developable areas in Atascadero have been developed. In response, the 2021-2028 Housing Element includes a program to re-evaluate the City's inclusionary housing policy and consider replacing the policy with an inclusionary housing ordinance.

Purpose of Inclusionary Ordinances

Beginning in the early 1970s, cities and counties throughout California adopted inclusionary policies and ordinances as part of their overall affordable housing strategy. Similar policies are also prevalent in other jurisdictions across the country. Inclusionary housing ordinances are designed to increase the supply of affordable housing for lower-income households. They are also intended to reverse the harmful effects of exclusionary zoning practices which in past decades had the effect of blocking low-cost housing from many municipalities. Inclusionary housing ordinances achieve this purpose by requiring private housing developers to include a certain percentage of affordable housing units in their projects, thereby helping to logically integrate affordable units throughout each neighborhood.

Case Law and Legislative History

By 2007, more than 170 jurisdictions in California had adopted an inclusionary housing ordinance. In 2009, however, the authority of jurisdictions to enact such policies was challenged in two separate court cases. To address the challenges, the State legislature passed a bill in 2017 to ensure that local jurisdictions could adopt and implement inclusionary housing ordinances. This section summarizes the relevant case law and legislation in chronological order.

Palmer Case (2009)

In the Palmer case (*Palmer/Sixth Street Properties L.P. v. City of Los Angeles*), the Second District California Court of Appeal ruled that inclusionary housing requirements on rental units mandated by the City of Los

Angeles conflicted with 1995 Costa Hawkins Act, which allows landlords to set the initial monthly rent for a new unit and to increase the rent to market levels whenever a unit is vacated. After the Palmer decision (until AB 1505 became effective in 2018), most jurisdictions stopped applying inclusionary housing requirements on rental housing development.

Patterson Case (2009)

In another case before the California Court of Appeal during that same year (*Building Industry Association of Central California v. City of Patterson*), the court ruled that an in-lieu fee associated with the City of Patterson's inclusionary ordinance was not "reasonably justified" as required by the development agreement. This decision created some uncertainty as to what standard of review courts would use when assessing the validity of an inclusionary ordinance. This court found an inclusionary in-lieu fee to be a type of impact fee, rather than simply a land use control, and thus would require a nexus-type study to justify it.

Between 2009 and 2015, jurisdictions had great uncertainty as to how to implement their inclusionary housing ordinances; many were not enforced, particularly as related to new rental residential projects. In response, many jurisdictions replaced affordable housing production models with a linkage or impact fee methodology. However, in 2015 the Patterson decision was overturned by the California Supreme Court decision in *California Building Industry Association v. City of San Jose*, and in 2017 new legislation was adopted that clearly authorizes local jurisdictions' authority to adopt and implement inclusionary housing ordinances, including those for rental affordable housing.

CBIA v. City of San Jose (2015)

In 2015, the California Supreme Court ruled in *California Building Industry Association v. City of San Jose* that inclusionary housing programs are use restrictions that are a valid exercise of a jurisdiction's zoning powers. Importantly, this means that inclusionary housing requirements are deemed to be a planning tool and not an exaction—even if they include an in-lieu fee payment option—and are not subject to AB 1600 nexus requirements imposed by the "Mitigation Fee Act." However, price controls imposed by inclusionary housing programs must meet the following criteria:

1. The requirements cannot be "confiscatory"; and
2. The requirements cannot deprive a property owner of a fair and reasonable return on their investment.

The San Jose ruling that inclusionary housing programs are not an exaction applies to both ownership and rental residential development. However, the San Jose case did not overturn the limitations that the Palmer case imposed on inclusionary housing programs for rental residential projects, which rendered inclusionary housing ordinances for rental units invalid because rental property owners could not set initial rents as required by the Costa Hawkins law. Former Governor Brown publicly stated that he would not sign legislation that would undo the Costa Hawkins/inclusionary housing conflict, also known as a "Palmer Fix" bill, unless and until the California Supreme Court ruled in favor of the City of San Jose. When the Supreme Court found in favor of the City of San Jose, this ruling allowed for the subsequent passage and adoption of Assembly Bill (AB) 1505 in September 2017, known as the "Palmer Fix".

AB 1505 (The Palmer Fix – Effective January 1, 2018)

In a direct response to Palmer, AB 1505 authorizes jurisdictions to adopt inclusionary housing ordinances that requires a certain percentage of residential rental units be affordable to lower- and moderate-income households (Government Code Section 65850.01).

AB 1505 does not place a cap on the percentage of units that can be required to be affordable as part of an inclusionary housing policy. However, if the ordinance requires that more than 15 percent of the units be restricted to households earning less than 80 percent of the area median income (AMI), the California Department of Housing and Community Development (HCD) can require the jurisdiction to prepare an economic feasibility study. If HCD reviews and finds that feasibility analysis was not conducted by a “qualified entity with demonstrated expertise,” that the analysis was not sufficiently rigorous and followed “best professional practices,” and if the study was not made public for 30 days, the ordinance is still valid but cannot require more than 15 percent of units at 80 percent of median or below.

AB 1505 requires that inclusionary housing programs offer developers a range of options for fulfilling the affordable housing requirements. More flexible inclusionary housing policies improve the feasibility of these projects by offering developers various ways to meet affordability obligations. Beyond the on-site construction of a specified number of affordable housing units, these alternatives may include the following:

- Allow developers to pay fees in lieu of building inclusionary units on-site. These in-lieu fees can be leveraged by local jurisdictions and non-profit developers to build affordable housing. This option allows the affordable housing requirement to be transferred to a developer with more experience in the construction and operation of affordable housing projects. But it is critical that the in-lieu fee be set at a level sufficient to actually fund new construction. The dollars collected should be high enough to enable the city to finance construction of an equivalent number of affordable housing units elsewhere; otherwise, the number of units produced may end up being less than the number that would have been produced had the developer simply built the units themselves.
- Another option is the off-site construction of a defined percentage of income restricted units at a different project location. Typically, the developer is still responsible for actual development but will partner with another developer, again someone with more experience with affordable housing projects. With both in-lieu fees and off-site construction, a fully dedicated affordable housing project will have access to public funding sources that a private development will not. By leveraging the expertise of non-profit developers and accessing funding sources not available to private projects, these two options can provide a more cost-efficient way to build affordable housing. Ideally, the off-site construction should not be in an isolated location which would restrict the extent to which the new development could promote residential, social, and economic integration of its residents with the surrounding community. If this is not possible, the alternative site could be justified by requiring the production of a larger number of affordable units than would have been built at the original site.
- Some inclusionary housing ordinances allow developers to dedicate land that can accommodate the same number of affordable housing units that would have be required at the original project

site. With this option the responsibility for construction of the affordable housing will fall on the local jurisdiction, which typically will deed the property to a community-based non-profit developer. The property should be equal to or greater in value than the in-lieu fee and large enough to ensure production of an equivalent number of affordable housing units. Again, isolated plots of land should be avoided. The capacity of local non-profit developers to undertake the development is a critical consideration, as is the existence of adequate sewer and water capacity and other infrastructure, the availability of financing to improve the land and build and operate the housing, and the level of public acceptance by the surrounding community.

- A transfer of credits allows developers to build more than the required number of affordable units in one project to compensate for building fewer such units in another project.
- Instead of constructing new affordable units on-site, developers may have the option of acquiring and rehabilitating existing off-site units. This option could also include the adaptive re-use of an existing non-residential building for new affordable housing.

By providing off-site and in-lieu fee options, the affordable housing requirements can be transferred to developers that have experience in constructing affordable housing projects. This is beneficial for multiple reasons, including: (1) affordable housing developers have expertise in developing and operating affordable housing projects, which may be difficult for other developers (especially long-term project holders), and (2) affordable housing developers use a variety of public funding sources to layer funding and achieve affordable housing, which can support deeper affordability and additional units. However, this can result in concentrating affordable housing units in a smaller number of developments, rather than integrating units throughout the city.

Key Components of Inclusionary Housing Programs

Although characteristics of inclusionary programs vary widely among jurisdictions, most share the following aspects and components:

- Most are mandatory and are required with every new housing development over a specific threshold (e.g., 5 or more units); however, some programs (like the City of Atascadero's) are only incorporated into legislative level projects, such as those that are requesting a General Plan modification, zone change, or other variances from requirements.
- Most ordinances apply to both rental and ownership housing.
- Most ordinances exclude very small projects; the threshold is typically between five and 10 or fewer units, below which new projects are not subject to affordable housing requirements.
- There is significant variation in the affordability standards of Inclusionary Housing programs throughout California. The majority of programs require between 10 and 20 percent of the units in projects to be affordable, at varying levels of affordability.

- There is variation in length of affordability requirements; however, the prior standard in California Redevelopment Law of 45 years for ownership housing units and 55 years for rental units is commonly used (though both shorter and longer covenant periods exist).

II. Summary of City of Atascadero's Inclusionary Policy

Background

During the 2001 update to the Atascadero General Plan, the City Council recognized that rising housing prices were not accommodating local working families, many of whom had lived in the community for generations. As a result, an inclusionary housing ordinance was adopted in 2003, requiring a 20 percent set-aside for all developments requiring legislative approval (including zone changes, planned unit developments, and specific plans). Affordable units developed under the inclusionary policy must be deed restricted to households of very low, low, and moderate incomes. The policy requires an in-lieu fee of five percent of the construction valuation of the market rate units within a project that does not provide 20 percent of the units as affordable. All inclusionary units are required to be deed restricted for a period of 30 years. All residential projects under legislative approval are subject to the inclusionary requirement as follows:

- Projects of 1 to 10 units can pay in-lieu fee or build units.
- Projects of 11 or more units must build units or receive a Council approval to pay in-lieu fees.

The Inclusionary Housing Policy requires that all affordable units in single-family land use areas be designated for moderate-income households. The distribution of affordable units in multi-family and mixed-use commercial land use areas are 20 percent very low income, 37 percent low income, and 43 percent moderate income. Affordable units must be constructed at the same time as the market-rate units, and affordable units must be physically distributed throughout the project site, rather than concentrated in one area. To ensure compliance with these requirements, a construction timeline detailing the development of affordable units and a site map must be approved by the City Council. With City Council approval, alternatives to on-site construction or payment of in-lieu fees for inclusionary units may be allowed, including off-site construction, land dedication, combinations of construction, fees, and/or land dedications. All inclusionary units are treated as density bonus units that are not counted as part of the maximum density entitlement of a site.

For-sale inclusionary properties may participate in a "shared equity purchase program." Under the equity sharing program, the buyer of an affordable unit enters into an agreement with the City that upon resale of the property eventually returns a share of the property's accrued equity to the City for use in other citywide affordable housing developments. The affordability of the ownership units is maintained by a promissory note valued at the below-market benefit of the particular unit, which is evidenced by a second trust deed recorded on the property at time of sale.

Past Performance of City of Atascadero's Inclusionary Ordinance

As shown in Table 1 below, the City of Atascadero's inclusionary ordinance resulted in the construction of 147 affordable housing units between 2003 and 2020. Most of the construction—144 units—occurred prior to 2007. There was a seven-year gap from 2008 through 2014 during which no affordable housing units were built via the inclusionary policy. This period corresponds to the economic downturn in the housing market.

Over half (55 percent) of the inclusionary units produced were moderate-income housing units, as a majority of legislative projects are small lot single-family subdivisions. Very low-income housing units account for 23 percent of the total and low-income the balance at 22 percent. Affordable units were included in Apple Valley, the Colony Homes development, Las Lomas, and Dove Creek.

Table 1: Atascadero Inclusionary Housing Units Constructed

Year	Units Constructed by Income Level			Total
	Very Low	Low	Moderate	
2003	2	2	2	6
2004	2	24	21	47
2005	2	0	25	27
2006	10	5	31	46
2007	18	0	0	18
Subtotal 2003 - 2007	34	31	79	144
2008-2014	0	0	0	0
2014	0	1	0	1
2015	0	0	0	0
2016	0	0	1	1
2017-2019	0	0	0	0
2020	0	0	1	1
Subtotal 2008 - 2020	0	1	2	3
Total 2003-2020	34	32	81	147

In addition, three projects are in the development stages that have committed to providing affordable housing through the inclusionary policy, as outlined in Table 2, which will provide an additional 22 units of affordable housing in Atascadero.

Table 2: Atascadero Inclusionary Housing Units In Planning Process

Project Name	Units Constructed by Income Level			Total
	Very Low	Low	Moderate	
Grand Oaks Micro Community	0	0	3	3
Hartberg Multi-Family Planned Development	3	6	6	15
The Principal Mixed-Use Project	0	3	1	4
Total	3	9	10	22

To note, this summary of inclusionary housing units in Table 1 and Table 2 is not inclusive of all affordable housing in Atascadero. Additional affordable housing projects have been created through grant funding and tax credit financing, including:

- The Knolls at the Avenida (59 affordable units for families)
- Atascadero Senior Apartments (19 affordable units for seniors)

Since 2003, over \$1.11 million in lieu-fees have been collected by the City. These fees are used (often along with other funding sources) to finance affordable housing developed off site. Projects that have been funded with in-lieu fees include support for land acquisition for affordable housing, housing rehabilitation and preservation as affordable housing, and to support affordable housing developers' payment of impact fees, thereby reducing the overall cost of the project.

Changes Since Inclusionary Policy Adoption

The City's 2001 General Plan and Housing Element updates initiated a period of both commercial and residential growth. The City's inclusionary housing policy was highly successful during the early years, with projects such as Los Lomas/Woodridge, where inclusionary units were mixed in with the development of 270 single-family homes, townhomes, and apartments, and Dove Creek, which had a similar housing type mix.

However, as the remaining large developable areas have dwindled, market conditions have changed, and State laws have been modified (and lawsuits have changed the landscape), inclusionary housing projects have decreased. The ability for developers to provide affordable units based on economies of scale often diminishes on smaller lots; larger tracts of land make the construction of affordable units more financially feasible as the financial impacts of affordable units can be spread across more market-rate units. Construction costs have also increased throughout California, in terms of both material and labor costs. New State requirements, including solar installation for all new single-family homes, have also increased construction costs. All of these factors have resulted in a narrowing of profit margins for new development. At the same time, there has also been a shift towards building housing that is "affordable by design" rather than being deed-restricted affordable housing, particularly in private, for profit development projects where grant finding is not sought or applicable. In Atascadero, trends are shifting

toward smaller units and higher density than has been in demand before. This may be due partly to the economic factors cited here, as well as changing housing preferences in the market.

In addition, changes to State laws include (1) increasingly generous State Density Bonus provisions, (2) strengthening of the Housing Accountability Act and related limitations on jurisdictions to deny projects or reduce density (as well as more emphasis on requiring housing to be allowed “by-right” without a public hearing or discretionary approval), and (3) the rescinding of redevelopment law, which eliminated a structure for requiring affordable housing and a related funding source. State Density Bonus regulations and the Housing Accountability Act are described in more detail below.



Los Lomas Village

Density Bonus

The State Density Bonus law (Government Code Section 65915) is often used in tandem with inclusionary housing policies to lessen the financial impact of inclusionary housing policies on developers.¹

Section 65915 requires the City to adopt an ordinance that specifies how it will comply with the State-mandated density bonus requirements. The City’s density bonus ordinance (Zoning Code Article 30) was last amended in 2013. Various new State laws have amended the density bonus requirements since 2013. Until the City’s density bonus ordinance is updated (which is an implementation action of the Housing Element and will be funded with SB 2 grant funds), the State law governs and supersedes City policies over any inconsistencies.

Over the years, the State Density Bonus law has become increasingly more generous, allowing additional incentives at lower thresholds for the development of affordable housing. The most recent law, AB 2345

¹ In 2013, in *Latinos Unidos del Valle de Napa y Solano v. County of Napa*, the First District Court of Appeal ruled that jurisdictions must allow developers to use the same affordable units to fulfill both inclusionary housing ordinance and density bonus requirements (as long as the more stringent of the two programs’ requirements are applied).

(effective January 2021), decreases the percentage of units that must be affordable in a development while simultaneously increasing the allowed bonuses and concessions. Specific changes associated with AB 2345 include:

- Requires 17 percent of the total units be for lower-income households rather than 20 percent to qualify for two incentives/concessions.
- Requires 24 percent of the total units be for lower-income households rather than 30 percent to qualify for three incentives/concessions.
- Increases cap of bonus percentage from 35 percent to 50 percent.

Density bonus law allows for-sale units to be provided at the moderate level (not lower-income); most inclusionary units produced in Atascadero have been for-sale units and thus moderate-income level. As a result, the City has been limited in its ability to require low- or very low-income units. Furthermore, in Atascadero, developers have used the density bonus process to access the allowed incentives/concessions, even if additional *density* is not needed (or constructed). Prior to the changes to State Density Bonus law, these projects may have instead endeavored to use the variance process to achieve the same effect.

Given the generous approach to State Density Bonus law, it is difficult for the City to provide any additional incentives for affordable housing provisions. In addition to increases in density, developers are often interested in accessing the incentives and concessions available to address site planning issues, including reductions in setbacks, parking, and open space, which are all accessible through State Density Bonus law.

The City's inclusionary housing regulations require that housing remain affordable for 30 years; State density bonus requires a 50-year term. As such, as project developers ask for concessions, the City is able to increase the deed restriction requirement associated with the inclusionary housing ordinance from 30 to 55 years (consistent with State Density Bonus law provisions). However, once a moderate-income deed-restricted unit sells for a moderate price in the free market, the affordability covenant is no longer required, thus reducing the local deed-restricted moderate-income affordable housing, which is generally what is considered "workforce housing".

Given the current local market conditions, deed-restricted very low- and low-income units are the least likely to be provided in the free market, and are the most highly needed.

Housing Accountability Act

The Housing Accountability Act (HAA) was enacted in 1982 to address the high cost of housing in California. The act, strengthened in 2018 with a package of housing bills signed by former Governor Jerry Brown, protects both of the following:

- Developments that comply with all "applicable, objective general plan, zoning, and subdivision standards and criteria." **Local governments may not disapprove – or reduce the density/size of – multi-family residential and mixed-use projects** unless they find that the project would have an unavoidable impact on public health or safety that cannot be mitigated in any way other than rejecting the project or reducing its size.

- Developments that contain a minimum amount of affordable housing (either 20 percent of units for lower-income households or 100 percent of units for moderate-income), even if the projects do not comply with all objective standards. Local governments may not disapprove or reduce the size of qualifying affordable housing projects except under specific circumstances defined in the statute.

This modification to the Housing Accountability Act is consistent with a recent and consistent statewide legislative push toward requiring jurisdictions to increase local by-right approvals (removing discretionary actions, as well as some legislative action, thus no longer triggering the inclusionary policy).

In Atascadero, because the inclusionary housing policy is linked only to legislative actions (general plan amendments, specific plans, zone changes), only certain housing developments are required to comply with the inclusionary housing regulations. For example, a small lot subdivision of four homes that is part of a planned development would be required to comply and provide affordable housing or pay an in-lieu fee; however, a larger project that is fully consistent with zoning regulations (such as Emerald Ridge, with 208 units) would be reviewed by the Planning Commission through the Conditional Use Permit process, but would *not* be subject to the inclusionary requirements. This has resulted in a feeling of unbalance in the applicability of the inclusionary policy.

Atascadero Recent Policy Direction

In previous Housing Element updates, the City included an action item to consider adoption of an inclusionary housing ordinance that expands the existing inclusionary policy to require more residential developments to provide deed-restricted affordable units or pay an in-lieu fee. In 2008, the City approved a new Affordable Housing Funds Policy that established affordable housing goals, policies, and prioritization criteria for the allocation of affordable housing funds.

The 2021-2028 Housing Element includes this Implementation Action: “Evaluate the City’s inclusionary housing policy and consider replacing the current inclusionary policy with an inclusionary housing ordinance...consistent with State density bonus regulations and [that] address[es] changing economic and regulatory considerations.

III. The Balancing Act

Inclusionary housing ordinances are promoted as a way to produce a wider range of housing choices, for a variety of income levels—more than the free marketplace can do on its own. However, if affordable housing requirements are set too high, developers may not be able to make a sufficient profit and may choose not to build at all, ultimately reducing overall housing production. Over time, inclusionary housing policies may also have an impact on land prices, as the market adjusts to reflect the inclusionary housing restrictions in place. In addition, consistent with case law, inclusionary housing requirements cannot be confiscatory or deprive an owner of a fair and reasonable return on his/her investment. Moreover, California Housing Element law² requires any jurisdiction with an inclusionary housing policy or ordinance to analyze potential and actual constraints being placed on the development of housing by that ordinance.

² Government Code Section 65583(a)

For these reasons, any ordinance should be carefully designed to avoid placing an onerous financial burden on developers which could then hinder market rate housing development.

Critically, an inclusionary housing ordinance by itself cannot produce all the affordable housing units that may be in demand or that may be required by the State RHNA targets. While Atascadero was significantly more successful than most jurisdictions in meeting the regional housing needs allocation targets set by the State and San Luis Obispo Council of Governments, local production of very low- and low-income housing during the past five years did not achieve construction goals (see Table 4). In addition, the State of California has determined that household overcrowding and over payment issues effectively increase the need for affordable housing above these RHNA targets.

Table 4: Atascadero 2014-2019 Regional Housing Needs and Progress

Objectives		Income Levels				Total
	Extremely Low-Income Units	Very Low-Income Units	Low-Income Units	Moderate-Income Units	Above Moderate-Income Units	
Construction Objectives						
Goal	49	49	62	69	164	393
Progress	0 (0%)	48 (98%)	28 (45%)	178 (258%)	308 (188%)	562

Other complementary affordable housing strategies can also support provision of a variety of housing choice, including encouraging (or requiring) projects to provide housing that is affordable by design, such as limiting single-family housing types on multi-family properties and/or limiting average unit size for multi-family developments.

IV. Options and Recommendations

A fundamental consideration should be that the inclusionary housing ordinance not place an onerous financial burden on the developers of market-rate housing. As such, it must be carefully crafted to achieve affordable housing goals and avoid unintended consequences.

Inclusionary Housing Ordinance Factors to Consider

In considering an inclusionary housing ordinance that requires on-site units (and allows for alternatives consistent with AB 1505), **it is recommended that the City conduct an economic study** to best determine the appropriate affordability thresholds and optional in-lieu fee.

The courts have held that affordable housing is a “public benefit” and that locally imposed inclusionary housing ordinances are a legitimate means of providing this public benefit. However, the courts have also ruled that inclusionary housing regulations cannot be confiscatory, and they cannot deprive a property owner of a fair and reasonable return on an investment. However, no guidance is provided as to how these requirements should be met. Many California inclusionary housing programs have assumed that a

policy that results in a reduction in land costs of approximately 30 percent would be consistent with these case law requirements.

To understand the appropriate parameters for an individual jurisdiction, an economic study estimates the achievable market rate monthly rents and the defined affordable rents for a variety of unit sizes, the difference between which is identified as the affordability gap. The affordability gap equates to the recommended in-lieu fees per affordable unit. In the development of an inclusionary housing ordinance, the key factors that must be considered are:

- **Percent of units required to be affordable:** Throughout the State, jurisdictions have varied in the percentage of project units that are required to be affordable through an inclusionary housing ordinance. The City of Long Beach and Keyser Marston Associates, Inc. conducted an exhaustive search and summarized 68 inclusionary housing programs in California (see Attachment 1 for the Long Beach report's summary of programs).
- **Threshold of applicability:** Some jurisdictions exempt small projects from inclusionary housing requirements. Common thresholds include one unit, five units, and 10 units (see Attachment 1).
- **Affordability:** There is variation in the level of affordability required. Some jurisdictions require provision of very low-income units (50 percent of the area median income), some require low-income units (80 percent of the area median income), some require moderate-income units (120 percent of area median income, and some with a proportion of each (like Atascadero's existing inclusionary policy). Jurisdictions also have established different thresholds for renter and ownership products. In general, ownership units are reserved for moderate-income households (not very low- or low-income households) since moderate-income households are more likely to have the necessary disposable income to address the costs associated with homeownership. However, in a jurisdiction where most of the new housing product is for sale rather than rent, this can significantly limit amount of new lower-income housing units that come on line.
- **In lieu fee:** An economic study can assess the appropriate amount for the in-lieu fee and a calculation methodology.
- **Covenant period:** The inclusionary ordinance should re-evaluate the existing affordable housing covenant time period and consider adjustments based on best practices. While some jurisdictions throughout California have limitations of 30 years like Atascadero, many have increased restrictions to last 55 years (and some in perpetuity).

Pros and Cons of Inclusionary Housing Ordinances

The benefits of inclusionary housing ordinances are significant:

- Affordable units in market-rate developments can be constructed more quickly than non-profit affordable units, which require more time for financing.
- Construction of affordable units throughout different neighborhoods can meet a wider array of housing needs than concentrating a larger number of units in one development as a traditional

100 percent affordable project. Due to the wider variety of types of housing constructed, inclusionary housing can expand the housing choices available to lower-income families.

- The presence of affordable units within each residential project provides more opportunities for residents to remain in the community.

The drawbacks relate to how an inclusionary requirement can increase the costs of development and potentially reduce residential construction. The goal of an inclusionary requirement is to produce additional affordable housing. This goal is unachievable if increased construction costs due to the inclusionary requirement are too high and discourage residential development. In addition, inclusionary ordinances can require significant administration to ensure that small numbers of affordable units across multiple projects are rented or owned by qualified residents.

Other Affordable Housing Tools to Consider

In addition to, or instead of, an inclusionary housing ordinance, there are other affordable housing tools that the City may want to consider, including (1) an affordable housing impact fee and (2) efforts to encourage (or require) affordability by design.

Affordable Housing Impact Fee

Linkage fees and affordable housing impact fees are policy tools that generate revenue to support the creation of affordable housing by charging a fee on new development, and are used by jurisdictions throughout California. A nexus study must be prepared to demonstrate the connection between the fee and the need for affordable housing. Affordable housing impact fees are assessed on market-rate residential development on the assumption that an influx of new residents will generate increased demand for services and, in turn, low-wage jobs to fulfill that demand. The revenue from affordable housing impact fees can then be used to help provide housing affordable to these workers. Linkage fees are assessed on nonresidential development (commercial and industrial), understanding that these facilities stimulate the creation of jobs, and thus a need for housing. The need to meet the demand for affordable housing created by new growth provides the legal justification for charging linkage fees, which are used to preserve or create affordable housing near the jobs that are created.

When selecting a fee amount, communities strive to develop formulas that generate as much revenue as possible to support local affordable housing goals while avoiding unintended negative impacts on new development. Linkage and affordable housing fees that are too high could suppress economic growth in the short run and lead to higher land prices in the long run. Many communities choose to engage a consultant or other specialist when designing their formulas to help balance these competing priorities.

Linkage or impact fees are sometimes confused with in-lieu fees. When a developer is required to build units on site but allowed to pay a fee as an alternative, the fee is called an “in-lieu fee.” When a program is structured to require fees for all new residential and/or commercial projects across the board instead of requiring onsite units within certain projects, the fee is called an “impact fee” or “linkage fee.” Some jurisdictions in California have opted to require affordable housing impact fees or commercial linkage fees rather than require units to be provided through an inclusionary housing ordinance. Some jurisdictions have a blended program, requiring payment of a linkage fee for new commercial development and

inclusionary housing provisions for new residential development (with on-site units and an option for in-lieu fee payment).

To institute an affordable housing impact fee or a linkage fee, the City would need to conduct a nexus study to determine appropriate fees.

Pros and Cons of Affordable Housing/Linkage Fees

Affordable housing/linkage fees are an effective tool in the creation of affordable housing because they create a dedicated funding source to support development. This option allows affordable housing to be built by a developer with more experience in the construction and operation of affordable housing projects. This options also allows the City to make a significant contribution to affordable housing projects, which often require multiple sources to secure financing, by consolidating fees from multiple projects. Furthermore, there can be economies of scale in the development of larger-scale projects, making these projects less expensive on a per-unit basis. Single-site projects that can be financed through such fees are also generally less costly, on a per-unit basis, to operate than units that are located throughout a community through an inclusionary policy because of efficiencies in administrative, maintenance, and other operating costs.

The drawbacks are similar to an inclusionary requirement in that such impact fees can increase the costs of development and potentially reduce residential construction (for an affordable housing fee) and hinder economic development and job creation (for a linkage fee). Another consideration is that impact fees result in the investment of affordable housing fees within a few individual projects within a community, rather than spreading that investment throughout the community and can result in a more narrow housing type as these project tend to be larger scale for-rent projects.

Affordable by Design

In conjunction with an inclusionary housing ordinance, some jurisdictions have considered additional tools to encourage or require housing to be more “affordable by design.” In locations where land costs are slightly lower than surrounding more expensive areas, demand for new construction (and the related profit margins) tend to be higher for single-family product type over multi-family attached housing such as apartments and condominiums.

In Atascadero, the HDR zone requires a **minimum density** (as required by the State) to increase the amount of lower-cost, smaller units which are affordable by design. Outside of the HDR zone, Grand Oaks Micro Homes on El Camino Real is an example of affordability by design. This project, currently under construction on 1.7 acres, will provide 26 cottage homes, four live/work units, and a community center. Three units are deed-restricted as affordable to moderate-income households (as part of a density bonus agreement). The remaining 27 units are expected to be affordable by design to moderate-income households based on sales price. Housing sizes within this development range from 703 square-feet to 940 square-feet.

The Grand Oaks project provides an excellent prototype for a lower-cost housing option. The model tends to be more difficult to execute, however, on smaller lots (where achieving required parking becomes difficult), and on sloped lots where the topography interferes with simple building design (which often occurs in Atascadero). Cost savings are most often achieved when the geometry and massing of buildings can be very basic: a repetitive typology that is simple to draw, bid, build, and market.

Some jurisdictions require a **maximum unit size** in multi-family zones to support affordable housing by design. Maximum unit sizes may be applied across all units, or as a maximum average unit size for planned developments and multi-family developments. In West Hollywood, the City limits the average size of all dwelling units within a new residential project to 1,200 square feet in the high-density residential zone, not including any required inclusionary units (which may be smaller). This approach limits the construction of larger units, which would command higher rents and sales prices.

To further incentivize affordability by design, some jurisdictions have employed a **fractional density** system, where smaller units count as 0.5 or 0.66 of a unit for the purposes of determining allowable density. This allows developers to develop more units within the same underlying density as an incentive for smaller affordable-by-design units. Some jurisdictions also allow additional design flexibility for affordable housing and/or smaller unit sizes to encourage development, including alternative parking strategies and setbacks. The County of San Luis Obispo **discourages very large homes** (larger than 2,200 square feet) by charging affordable housing fees only on units larger than that threshold, and at increasingly higher rates for larger homes. Many jurisdictions also waive fees for affordable housing developments and offer project streamlining, moving affordable housing projects to the front of the line.

Pros and Cons of Affordable by Design

In general, units that are affordable “by design” cost less to produce because they are small and efficiently designed. This savings in cost can be passed onto the consumer. One of the benefits of this model is its simplicity – these units can be produced by interested developers and require no additional tracking by the City. However, in order to adequately encourage a substantial number of affordable by design units, the City will need to actively encourage developers and likely provide incentives (or requirements) for developers to provide this type of housing.

While units that are affordable by design contribute directly to a lower housing cost burden for the families that reside within them, without a deed restriction or requirement, rents and sales prices may eventually rise to levels that are considered unaffordable. Furthermore, affordable by design will not produce any very low- or low-income units, which are of the highest need.

V. Case Studies/Examples

Attachment 1 provides an overview of 68 inclusionary ordinances in California, compiled by the City of Long Beach and Keyser Marston Associates, Inc. in 2019. Additional detail on three local ordinances is summarized below (County of San Luis Obispo, City of San Luis Obispo, and Pismo Beach).

County of San Luis Obispo

In 2008, the County of San Luis Obispo adopted an inclusionary housing ordinance. It was to be phased in over a five-year period. In the first year, the ordinance stipulated that residential development projects must reserve four percent of all new residential units for occupancy by workforce-moderate, low-, or very low-income households. After five years, the requirements were to rise to a maximum of 20 percent of all new residential units. As an alternative to constructing inclusionary housing units (on-site or off-site), developers were also given the options of opting out by paying an in-lieu fee for each market rate unit or by donating land. In the first of the five years, the in-lieu fee was a modest 75 cents per square foot but after five years was to reach a maximum of \$3.75 per square foot.

As a result of the housing market crash that year, the phased approach was put on hold. Affordability requirements and in-lieu fees remained unchanged until 2019 when the Board of Supervisors voted to amend the policy by requiring multi-family developments to set aside eight percent of their units (instead of four percent) for affordable housing, in effect only the second year of the original five-phase plan. This modest increase is still far short of the originally conceived 20 percent at the end of the first five years. In 2016, the in-lieu fee was raised to \$1.50 per square foot, or 40 percent of the original \$3.75 maximum.

The move to amend the inclusionary housing ordinance was motivated by the increasing cost of housing in a county where only five percent of households can afford the average priced home of \$600,000 and 31 percent of renters pay more than 50 percent of their income on rent. San Luis Obispo County has become the six least affordable place to buy a home in the United States.

During its first decade, only one project incorporated affordable housing units under the inclusionary housing ordinance. In 2017, the Templeton Ranch project provided five on-site affordable housing units. Now with the new in-lieu fee in place, yearly revenue from the fee is expected to increase from less than \$50,000 to more than \$1 million.

Under the revised 2019 ordinance, residential development with one or more units is subject to the inclusionary housing requirements (although rental housing, accessory dwelling units, and assisted living facilities are exempt). In addition, commercial, industrial, and mixed-use development must pay an affordable housing linkage impact fee.

Only new homes over 2,200 square feet in size are subject to in-lieu fees. The planning director calculates the in-lieu fee according to the following rate schedule:

- The first 2,200 square feet of the unit is exempt from paying fees.
- The portion of the unit between 2,200 square feet and 2,500 square feet pays a fee of \$8 per square foot.
- The portion of the unit between 2,500 and 3,500 square feet pays a fee of \$12 per square foot.
- The portion of the unit above 3,500 square feet pays a fee of \$16 per square foot.
- The maximum fee for any single unit shall not exceed \$7 per square foot as calculated using the entire square footage of the residence.
- Units greater than 4,600 square footage are not subject to this rate schedule but simply pay a rate of \$7 per square foot.

San Luis Obispo County allows for alternative methods in addition to constructing inclusionary housing units on site or paying an in-lieu fee (for units over 2,200 square feet). Existing housing units on the site of a new development may be designated as inclusionary housing units if they meet required design standards. This does not apply to existing housing units that are off site. However, constructing new inclusionary housing units off site does qualify, provided the off-site location is in the same housing market area. Finally, developers can donate land located on site or off site of the proposed development.

For inclusionary units built on site, a portion of the base density (eight percent) must be set aside for affordable housing. Inclusionary housing units must be provided for each qualified income group per the following structure:

- Workforce households (earning up to 160% of the area median income) – two percent

- Moderate income households (earning 80-120% of the area median income) – two percent
- Low-income households (earning 50-80% of the area median income) – two percent
- Very low- income households (earning up to 50% of the area median income) – two percent
- Project total – eight percent

Within each residential development project, inclusionary housing units are also to be provided in a required sequence. The first required inclusionary housing unit must be for workforce households, the second for moderate-income households, the third for low-income households, and the fourth for very low-income households. The sequence then repeats itself for every additional inclusionary housing unit.

Multiple incentives are in place to encourage the provision of inclusionary housing units. With any approved residential development, one density bonus unit is granted for each required inclusionary housing unit constructed on site or off site. In addition, when all of a project's inclusionary housing requirements are met by providing those units on site, the inclusionary requirements of setting aside eight percent for affordable housing is reduced by 25 percent.

If the number of dwellings constructed on site will exceed the base density amount, then the developer can request an additional incentive. In these instances, the County can grant at least one modification of residential development standards for parking, height, private yard space, setback, or parcel size.

The County also encourages the development of affordable housing within incorporated city limits. If a developer satisfies the inclusionary housing requirement through alternative methods such as providing off-site inclusionary housing units of donation of land for affordable housing and this results in development of affordable housing units within the urban limits of an incorporated city within the County, then the inclusionary housing requirement is reduced by 25 percent.

The following development standards apply to the design of inclusionary housing units:

- They are to have compatible exterior designs and finishes to the development's market-rate units.
- They may be smaller in size and have different interior finishes, features, and appliances, as long as the interior components are durable, of good quality, and consistent with contemporary standards for new housing.
- In 50 percent or more of the inclusionary housing units, the average number of bedrooms must be equal to or greater than the average number of bedrooms in the development's market rate units.
- Up to 30 percent of the inclusionary housing units can be accessory dwelling units.

City of San Luis Obispo

As of 2020, the City of San Luis Obispo had a total of 1,306 affordable housing units. Twenty percent of these (264 units) are included within the inclusionary housing program. Most of the inclusionary program affordable housing units (71 percent) are rentals, 27 percent are ownership units, and two percent are mixed ownership and rental. Additionally, the City has granted, loaned, or committed \$10,450,954 of affordable housing in-lieu funds to assist with the development of 464 new deed-restricted affordable housing units. The City's inclusionary housing ordinance was adopted in 1999. It targets very low-income, low-income, and moderate-income populations.

Inclusionary housing requirements are imposed on developments of five or more units. The percent of required affordable housing units varies depending on whether the project is within city limits or its “expansion area,” which is land area proposed for annexation or annexed after the adoption date of the ordinance (see Table 5 below). These requirements can be adjusted based on project density and average unit size.

Table 5: City of San Luis Obispo Inclusionary Housing Requirements

Inclusionary Housing Requirements	
In City Limits	<ul style="list-style-type: none"> • Build 3 percent low <u>or</u> 5 percent moderate income Affordable Housing Units (AHUs) but not less than 1 AHU per project, or • Pay in-lieu fee equal to 5 percent of building valuation
In Expansion Area	<ul style="list-style-type: none"> • Build 5 percent low <u>and</u> 10 percent moderate income AHUs (15 percent total), but not less than 1 AHU per project, or • Pay in-lieu fee equal to 15 percent of building valuation

These housing units must remain affordable for a specified length of time before they can be sold at market rate prices. Older agreements have a 30-year deed restriction, but the most recent agreement terms are 45 years for ownership housing and 55 years for rentals.

Alternatives to on-site construction include:

- in-lieu fees
- dedication of land for affordable housing
- rehabilitation of existing housing units that are vacant and in poor physical condition or otherwise uninhabitable
- a combination of the above methods is also possible with approval of the Director of Community Development

Developers are entitled to receive density bonuses and concessions when they agree to construct very low-, low-, or moderate-income dedicated units, consistent with State Density Bonus law. The extent of the bonus varies depending on the percentage of affordable income units in the project.

In 2020, the City of San Luis Obispo conducted an Affordable Housing Nexus Study to establish a rational nexus between market-rate residential development and nonresidential development and the need for affordable housing in the City. The 2021-2028 Housing Element states that the City will update the Inclusionary Housing Ordinance based on findings and recommendations in the 2020 Affordable Housing Nexus Study and conduct further feasibility analysis to evaluate the City’s ability to provide affordable housing in the proportions shown in the Regional Housing Needs Allocation.

Pismo Beach

The City of Pismo Beach had an estimated population of 8,213 in 2018. It is a built-out beach community with very high housing costs. To encourage affordable housing construction, the City adopted an inclusionary housing ordinance in 2001. For residential projects of five or more units, a developer can either: (1) pay an in-lieu fee equal to or greater than five percent of the building permit value or (2)

dedicate land or build affordable units of equal value to the fee. Commercial projects greater than 5,000 square feet must either: (1) pay an in-lieu fee of at least two percent of the building permit value or (2) build an affordable unit or dedicate land with value equivalent to the in-lieu fee. As of 2017, the inclusionary housing fund has a balance of \$3,360,000.

VI. Next Steps and Factors to Consider in Development of an Inclusionary Housing Strategy

The City should consider many options when designing an inclusive housing strategy that targets local needs and conditions. The State mandates, through our RHNA allocation, achievement of affordable housing opportunities throughout the community, at all income levels. In response to this State goal, the City should focus on an integrated inclusionary housing strategy that supports local community needs as well as regional and statewide efforts for increased affordable housing opportunities. There are currently three main approaches to an inclusionary housing framework: an Inclusionary Housing ordinance, a citywide impact fee, and affordability-by-design incentives and/or requirements.

1. Inclusionary Housing Ordinance

Adoption of an inclusionary housing ordinance would require that all projects over a determined threshold build affordable units on-site. The city must also allow for alternatives to meet this requirement, such as an in-lieu fee that can be paid under certain conditions. It is at the City's discretion to determine the scale of project and parameters for alternatives. Items to consider are:

- a. Project size threshold
- b. Approval level trigger (legislative action, all discretionary projects including CUPs and maps, or all projects, including by-right development)
- c. Percentage of affordability and affordability distribution among product types (rental vs. for-sale units)
- d. Affordability duration
- e. Alternative fee amount / amount of land dedication and parameters for allowing such alternatives

2. Citywide Impact Fee / Commercial linkage fee

As an alternative to an inclusionary housing ordinance, the City may consider a citywide affordable housing linkage fee and/or commercial linkage fee. Key features of this approach include:

- a. Can be applied citywide to all new development, both residential and commercial
- b. Can be structured based on residential square-footage so that larger houses, with greater impact on affordability, pay more while houses below a certain threshold are exempt as affordable-by-design
- c. Must be accompanied by a nexus study to determine true impact of development on affordable housing needs

3. Affordability-by-design

The City can implement development standards that encourage and/or require higher density projects to include units that area affordable-by-design, therefore meeting State goals without deed restrictions and in a way that distributes units over all projects throughout the City.

Standards may include:

- a. Establishing a maximum average or absolute unit size in multi-family developments to limit development of prime housing sites with traditional single-family units
- b. Factoring unit size into density calculations to allow more units to be built on a site if those units are smaller, affordable-by-design units.
- c. Establish design regulations that support higher density development by encouraging community parking and open space rather than a focus on private garages and yards.

An effective strategy can focus on one solution or can combine these strategies into a multi-pronged approach depending on the specific goals and need of the community. Identified community goals include equitable distribution of units throughout the city and developing a successful and robust program that can achieve balance between feasibility of implementation and ensuring compliance with State mandates.